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IN THE

Supreme Court of the United States

SHERWOOD PARTNERS, INC., ASSIGNEE FOR THE BENEFIT OF CREDITORS OF INTERNATIONAL THINKLINK CORPORATION,
PETITIONER

v.

LYCOS, INC., A DELAWARE CORPORATION AKA DELAWARE LYCOS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Is a state statute authorizing an assignee for the benefit of creditors to void a preferential transfer constitutionally incompatible with the federal Bankruptcy Code and, thus, preempted by federal law?

II. Did the Ninth Circuit err in ruling that, like state laws discharging debts, state statutes that implicate equitable distribution of an insolvent debtor's assets to creditors are preempted by federal bankruptcy law? The Ninth Circuit's ruling conflicts directly with this Court's precedent in *Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518 (1933), *Johnson v. Star*, 287 U.S. 527 (1933), and *Stellwagen v. Clum*, 245 U.S. 605 (1918).

LIST OF PARTIES

The Petitioner is Sherwood Partners, Inc., as assignee for the benefit of the creditors of International Thinklink Corporation. The Respondent is Lycos, Inc.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioner, Sherwood Partners, Inc., discloses that there is no parent corporation or publicly traded company owning more than 10% of the stock of Sherwood Partners, Inc., a California corporation.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

LIST OF PARTIES ii

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES vii

PETITION FOR WRIT OF CERTIORARI 1

OPINIONS BELOW 2

JURISDICTION 2

RELEVANT PROVISIONS INVOLVED 3

STATEMENT 3

A. Underlying Facts 3

B. Sherwood's District Court Anti-Preference Litigation 5

C. The Ninth Circuit's Decision 6

REASONS FOR GRANTING THE PETITION 8

I. THE NINTH CIRCUIT MAJORITY'S RULING THAT PREFERENCE RECOVERY UNDER CAL. CIV. PROC. CODE § 1800 IS *PER SE* UNCONSTITUTIONAL IS A MATTER OF NATIONAL IMPORTANCE 8

A. The Ninth Circuit Majority's Ruling Would Preempt Voluntary Assignment Laws in Fifteen States Beyond California 8

B. State Voluntary Assignment Laws And Anti-Preference Provisions Have A Longstanding And Venerable History 9

C. The Ninth Circuit Majority's Opinion Is In Direct Conflict With This Court's Test Requiring A Strong Presumption Against Preemption Of State Insolvency Laws 11

D. The Ninth Circuit Majority's *Sub Silentio* Promotion Of State Anti-Preference Laws That Encourage Individual Creditor Action Runs Contrary To The Recognized Purposes Of The Bankruptcy Code 16

E. The Ninth Circuit Majority's Opinion Could Undermine The Commercial Laws Of All Fifty States.....18

II. THE NINTH CIRCUIT MAJORITY OPINION IS IN DIRECT CONFLICT WITH THE GOVERNING DECISIONS OF THIS COURT INVOLVING STATE ANTI-PREFERENCE STATUTES 19

A. This Court's Decisions In *Pobreslo* And *Star* Each Involved Anti-Preference Statutes Providing The Assignee With Avoiding Powers Beyond Those Available To Individual Creditors 19

B. The Ninth Circuit Majority's Preemption Holding Is Based On A Fatally Flawed Effort To Distinguish This Court's *Stellwagen* Decision.....22

C. Even Assuming That The Test For Validity Of A State Anti-Preference Statute Is Whether A Single Creditor, Alone, Can Sue, California's Law Also Meets That Test 26

D. By Definition, Voluntary Assignments Are Collective Proceedings Designed To Achieve Equitable Distribution And Are In Harmony With Federal Bankruptcy Law 27

CONCLUSION 29

APPENDIX

Circuit Court opinion (01/12/05) 1a

District Court Order (01/10/03) 22a

District Court Judgment (01/17/03) 45a

District Court Order (02/14/02) 47a

Order Denying Rehearing (03/01/05) 66a

TABLE OF AUTHORITIES

CASES *Page*

Angeles Electric Co. v. Superior Court, 27 Cal. App. 4th 426, 32 Cal. Rptr. 2d 660 (1994) 15

Bates v. Dow Agrosciences, LLC, 125 S. Ct. 1788, 161 L. Ed. 2d 687, 73 U.S.L.W. 4311 (2005) 11

Batten v. Smith, 22 N.W. 342 (Wis. 1885) 10

Blonder v. Cumberland Eng'g, 71 Cal. App. 4th 1057, 84 Cal. Rptr. 2d 216 (1999) 15

Brainard v. W. J. Fitzgerald, 3 Cal. 2d 157, 44 P.2d 336 (1935) 26

Credit Managers Association v. National Independent Business Alliance, 162 Cal. App. 3d 1166, 209 Cal. Rptr. 119 (1984) 9, 10, 11

Dickson v. Kittson, 77 N.W. 820 (Minn. 1899) 10

Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963) 12

Francisco v. Aguirre, 94 Cal. 180, 29 P. 495 (1892) 10

Gelatt v. DeDakis ("In re Assignment for Benefit of Creditors of Mader's Store for Men, Inc."), 254 N.W. 2d 171 (Wis. 1977) 21

In re Dairyland Inc., 50 Pa. D. & C. 63 (Common Pleas Lehigh Cty. 1944) 10

In re M. Egan Co., 24 B.R. 189 (Bankr. W.D.N.Y. 1982) 13

In re Wisconsin Builders Supply Co. v. George D. Prentice, Jr., 239 F.2d 649 (7th Cir. 1956) 19, 21

Johnson v. Star, 287 U.S. 527, 53 S. Ct. 265, 77 L. Ed. 473 (1933) 10, 11, 12, 19

Kellogg v. Root, 23 F. 525 (W.D. Mich. 1885) 10

Mayer v. Hellman, 91 U.S. 496, 23 L. Ed. 377 (1875) 10, 11, 12, 14

Mechanics Bank of Richmond v. M. H. Rosenberg, 201 Cal. App. 2d 419, 20 Cal. Rptr. 202 (1962) 26

Ogden v. Saunders, 25 U.S. 213, 6 L. Ed. 606 (1827) 12

Penniman v. Cole, 49 Mass. (8 Met.) 496 (1844) 10

Philips v. The Ammon-Stevens Co., 3 Ohio Dec. 418 (Ohio Com. Pl. 1895) 25

Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 52 S. Ct. 262, 77 L. Ed. 469 (1933).....*passim*

Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947).....12

Saks v. Damon Raike & Company, 7 Cal. App. 4th 419, 8 Cal. Rptr. 2d 869 (1992).....26, 27

Seattle Ass'n of Credit Men v. Bank of California, 30 P.2d 972 (Wash. 1934).....10

Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation v. Lycos, Inc., 394 F.3d 1198 (9th Cir. 2005).....*passim*

Stellwagen v. Clum, 245 U.S. 605, 38 S. Ct. 215, 62 L. Ed. 507 (1918).....*passim*

Sturges v. Crowninshield, 17 U.S. 122, 4 L. Ed. 529 (1819).....12, 13, 14

Teague v. Howard Grocery Co., 95 S.E. 173 (N.C. 1918).....10

Triplett v. Williams, 269 Cal. App. 2d 135, 74 Cal. Rptr. 594 (1969).....27

W.L. Moody & Co. v. Carroll, 8 S.W. 510 (Tex. 1888).....10

Women's Athletic Club v. Anglo California National Bank, 90 Cal. App. 2d 850, 204 P.2d 411 (1949).....27

FEDERAL STATUTES

11 U.S.C. § 101 ..... 5, 13

11 U.S.C. § 303 13

11 U.S.C. § 305 ..... 12, 13

11 U.S.C. § 543 13

11 U.S.C. § 547 24

11 U.S.C. § 550 24

28 U.S.C. § 1441 5

28 U.S.C. § 1254 3

U.S. Const. art. I 3

Uniform Commercial Code § 9-102 18

Uniform Commercial Code § 9-317 18

STATE STATUTES

Ariz. Rev. Stat. § 44-1041 8

Cal. Civ. Code § 22.2 27

Cal. Civ. Proc. Code § 493.030 18

Cal. Civ. Proc. Code § 1800 ..... *passim*

Cal. Com. Code § 9102 18

Cal. Com. Code § 9317 18

Ky. Rev. Stat. Ann. § 379.070 8

Md. Code Ann. Com. Law § 15-101 8

N.C. Gen. Stat. § 23-3 8

N.H. Rev. Stat. Ann. § 568:27 8

N.J. Stat. Ann. § 2A:19-3 8

N.M. Stat. Ann. § 56-9-1 8

N.M. Stat. Ann. § 56-9-2 8

N.Y. Debt. & Cred. Law § 15 8

Ohio Rev. Code Ann. § 1313.56 8

Ohio Rev. Code Ann. § 1313.58 8

Ohio Rev. Stat. § 6343 ..... 24, 25

Ohio Rev. Stat. § 6344 ..... 24, 25

Pa. Cons. Stat. Ann. § 71 8

Pa. Cons. Stat. Ann. § 151 8

S.C. Code Ann. § 27-25-20 8

S.D. Codified Laws § 54-9-13.2 8

Tenn. Code Ann. § 47-13-116 8

Tex. Bus. & Com. Code § 23.09 ..... 8, 22

Wash. Rev. Code § 23.72.010 8

Wash. Rev. Code § 23.72.030 8

Wis. Stat. § 128.02 20

Wis. Stat. § 128.07 ..... 8, 20

OTHER AUTHORITIES

Beth Bates Holliday, 42 AM. JUR. 2d., *Insolvency* § 68 (2004) 11

John C. McCoid II, *The Occasion for Involuntary Bankruptcy*, 61 AM. BANKR. L.J. 195 (1987) 10

Douglas C. Michael, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 KY. L.J. 937 (1997) 11

Jeanne Philbin, 6 AM. JUR. 2d. *Assignments for the Benefit of Creditors* § 98 (2000) 11

Charles Jordan Tabb, *The Law of Bankruptcy* § 1.5 (1997) 9

Restatement (2d) of Trusts, § 282 27

PETITION FOR WRIT OF CERTIORARI

Sherwood Partners, Inc., as assignee for the benefit of creditors of International Thinklink Corporation ("Sherwood"), respectfully petitions this Court for a writ of certiorari to review the opinion of the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit"), Case No. 03-55247, dated January 12, 2005, which, by a divided court, held that a state statute authorizing an assignee for the benefit of creditors to void a preferential transfer is preempted by the federal Bankruptcy Code. The Ninth Circuit majority's opinion directly conflicts with this Court's precedent in cases involving voluntary assignments where the assignee held avoidance powers beyond those that could be exercised by an individual creditor. The Ninth Circuit majority's theory was that because the right to void preferences was granted by the state statute to the assignee, but not to an individual creditor, the state statute "trenched too closely" on the federal bankruptcy power, which thus preempted the state law. (Pet. App. 12a to 13a). This holding is also in direct conflict with this Court's test for preemption.

The Ninth Circuit majority's fails to follow this Court's precedent approving voluntary assignments for the benefit of creditors as a valid state law means for promoting equitable distribution of an insolvent debtor's assets to its creditors. Additionally, the Ninth Circuit majority (1) failed to recognize that the federal and state statutes for voiding preferences are entirely compatible, and that the state statute enhances the chance to recover preferentially transferred property, (2) disregarded the purpose of the federal and state laws to maximize the estate of insolvent debtors for the

benefit of creditors, (3) needlessly called into question state laws providing for assignments for the benefit of creditors, first enacted approximately 200 years ago, and now in force in California and 15 other states, and (4) has pronounced a rule which will often force debtor estates to be liquidated for the benefit of their creditors in costly and protracted federal bankruptcy proceedings rather than in state law assignment proceedings.

OPINIONS BELOW

The Ninth Circuit majority's opinion is reported at *Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005). (Pet. App. 1a to 21a). The majority opinion was authored by Judge Alex Kozinski. The dissent was by Judge Dorothy W. Nelson. (Pet. App. 17a to 21a). The Ninth Circuit's order denying Petitioner's petition for rehearing and suggestion for rehearing *en banc* is not otherwise published. (Pet. App. 66a). The opinion of the District Court of the Central District of California, which was reversed by the Ninth Circuit, is unreported. (Pet. App. 22a to 46a).

JURISDICTION

The judgment of the Ninth Circuit was entered on January 12, 2005. (Pet. App. 1a). Sherwood filed a timely petition for rehearing and suggestion for rehearing *en banc*. The Ninth Circuit denied the petition for rehearing and suggestion for rehearing *en banc* pursuant to an order entered on March 1, 2005.

(Pet. App. 66a). The certiorari jurisdiction of this Court is invoked in conformity with 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS INVOLVED

The majority opinion of the Ninth Circuit concluded that the United States Bankruptcy Code (*see* title 11 of the United States Code), enacted pursuant to the Bankruptcy Clause of the United States Constitution (*see* U.S. Const. art. I, § 8, cl. 4), preempts California Code of Civil Procedure Section 1800. Cal. Civ. Proc. Code § 1800, in pertinent part, provides that:

> The assignee of any general assignment for the benefit of creditors ... may recover any transfer of property of the assignor:
>
> (1) To or for the benefit of a creditor;
> (2) For or on account of an antecedent debt owed by the assignor before the transfer was made;
> (3) Made while the assignor was insolvent;
> (4) Made on or within 90 days before the date of the making of the assignment ...; and
> (5) That enables the creditor to receive more than another creditor of the same class.

See Cal. Civ. Proc. Code § 1800(b).

STATEMENT

A. Underlying Facts

International Thinklink Corporation ("Thinklink") was a messaging and communications company that offered its subscribers unified telephone

and message services. (Pet. App. 24a). Lycos owns and maintains a network of computer websites grouped under its brand (the "Lycos Network"), from which it makes a wide array of services and products available to Internet users. (Pet. App. 24a).

On December 21, 1999, Thinklink and Lycos entered into an E-Commerce Agreement (the "Original Agreement") pursuant to which the parties agreed to create a co-branded version of Thinklink's website (the "Thinklink Site") on the Lycos Network. (Pet. App. 24a to 25a). Visitors to the Lycos Network could access the Thinklink Site and, if they wished, could subscribe and pay for Thinklink's services. (Pet. App. 25a). During the approximately two-year term of the Original Agreement, Thinklink was to be the exclusive provider of message services on the Lycos Network. (Pet. App. 25a). For its access to the Lycos Network, Thinklink agreed to pay integration fees totaling $20,000,000 over the two years of the Original Agreement, to pay a portion of its net sales revenue, and to share any advertising revenue. (Pet. App. 25a).

On or about July 14, 2000, Thinklink made the first payment due under the Original Agreement in the amount of $3,000,000. (Pet. App. 25a). However, no other payments were made. On or about December 23, 2000, Thinklink and Lycos executed an Amended and Restated E-Commerce Agreement ("Amended Agreement"). (Pet. App. 25a to 26a). On December 26, 2000, Thinklink made a $1,000,000 payment to Lycos. (Pet. App. 25a to 26a).

On February 14, 2001, Thinklink made a general assignment for the benefit of its creditors to Sherwood,

as assignee, in accordance with California law. (Pet. App. 26a). There has been no case under the federal Bankruptcy Code commenced involving Thinklink, either voluntarily or, alternatively, involuntarily by Thinklink's creditors.

B. Sherwood's District Court Anti-Preference Litigation

On May 18, 2001, Sherwood, in its capacity as assignee for the benefit of creditors of Thinklink, filed a complaint (the "Complaint") commencing a lawsuit against Lycos, in the Superior Court of the State of California for the County of Los Angeles, pursuant to the anti-preference provisions of Cal. Civ. Proc. Code § 1800. (Pet. App. 26a). The Complaint alleged that on the account of an antecedent debt, while Thinklink was insolvent and within ninety days of the assignment, Thinklink made a payment to Lycos in the sum of $1,000,000 that enabled Lycos to receive more than any other creditor of the same class. (Pet. App. 26a). In its capacity as assignee for the benefit of Thinklink's creditors, Sherwood sought avoidance of the transfer to Lycos and recovery of $1,000,000 from Lycos pursuant to the provisions of Cal. Civ. Proc. Code § 1800. (Pet. App. 26a).

Lycos removed the action to the United States District Court for the Central District of California (the "District Court") on the ground of diversity jurisdiction pursuant to 28 U.S.C. § 1441. (Pet. App. 2a, 47a). On July 23, 2001, Lycos moved to dismiss the Complaint and asserted that Cal. Civ. Proc. Code § 1800 was preempted by the enactment of 11 U.S.C. § 101, *et seq.*

(the "Bankruptcy Code"), and was therefore null and void. (Pet. App. 47a).

On February 14, 2002, the District Court denied Lycos's motion to dismiss, holding that Cal. Civ. Proc. Code § 1800 was not preempted by the Bankruptcy Code because Cal. Civ. Proc. Code § 1800 does not intrude into a field occupied by the Bankruptcy Code and that the state statute does not conflict with the Bankruptcy Code. (Pet. App. 53a to 65a).

On October 4, 2002, Sherwood filed a motion for summary judgment on its claim to recover the $1,000,000 payment. (Pet. App. 23a). Lycos filed an opposition. On January 10, 2003, the District Court held that Lycos failed to establish any defense to the anti-preference action brought pursuant to Cal. Civ. Proc. Code § 1800 and that no genuine issue of material fact existed. (Pet. App. 24a). Accordingly, the District Court entered judgment on January 17, 2003, in favor of Sherwood, as assignee, for $1,000,000 plus prejudgment interest. (Pet. App. 45a to 46a).

C. The Ninth Circuit's Decision

On January 12, 2005, a divided panel of the Ninth Circuit held that Cal. Civ. Proc. Code § 1800 is preempted by federal bankruptcy law. *See Sherwood*, 394 F.3d at 1206. (Pet. App. 1a to 21a). As a result, the Ninth Circuit reversed the District Court's January 17, 2003, order. *Id.* (Pet. App. 13a).

The Ninth Circuit majority based its ruling on the holding that "statutes that give state assignees or trustees avoidance powers beyond those that may be

exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power." *See Sherwood*, 394 F.3d at 1205. (Pet. App. 12a to 13a). The Ninth Circuit majority's opinion is also based on its holding that, like state discharge laws that intrude upon federal bankruptcy law, "state statutes that implicate the federal bankruptcy law's other major goal, namely equitable distribution," are preempted. *See Sherwood*, 394 F.3d at 1203. (Pet. App. 9a). The Ninth Circuit majority's theory is that any state law that advances a goal of the federal bankruptcy law is necessarily preempted. The majority reasoned that because the federal bankruptcy law preempts state statutes that discharge the debtor from debt in furtherance of the bankruptcy fresh start goal, a state statute for voiding preferential transfers must also be preempted by the federal law because both further the goal of equitable distribution to creditors. *See Sherwood*, 394 F.3d at 1203-05. (Pet. App. 7a to 10a).

Judge Nelson dissented, stating that "the Supreme Court ... has never suggested that state laws that regulate the distribution of assets in a voluntary assignment might meet the same fate [as unconstitutional discharge provisions]." *See Sherwood*, 394 F.3d at 1207. (Pet. App. 18a). Judge Nelson further stated the practical effect of the majority's ruling is to "push corporations threatened with insolvency from the less stigmatic, and less costly, voluntary assignment scheme into the world of federal bankruptcy," and that "[t]his should not be the case ... both voluntary assignments and the bankruptcy system can 'peaceably coexist' as twin mechanisms aimed at distributing the resources of an insolvent debtor." *See Sherwood*, 394 F.3d at 1208. (Pet. App. 20a).

REASONS FOR GRANTING THE PETITION

I. THE NINTH CIRCUIT MAJORITY'S RULING THAT PREFERENCE RECOVERY UNDER CAL. CIV. PROC. CODE § 1800 IS *PER SE* UNCONSTITUTIONAL IS A MATTER OF NATIONAL IMPORTANCE

A. The Ninth Circuit Majority's Ruling Would Preempt Voluntary Assignment Laws in Fifteen States Beyond California

A review of the Ninth Circuit majority's ruling is of vital importance because assignment laws are in effect in almost half of the states, a majority of which authorize an assignee to void preferences. As recognized by the dissent, the opinion reached by the majority "would preempt any number of state laws governing voluntary assignments for the benefit of creditors ... ." *See Sherwood*, 394 F.3d at 1206. (Pet. App. 17a). In addition to striking down the California anti-preference statute, the majority's decision has effectively called into question the voluntary assignment laws of at least 15 other states that authorize an assignee to recover preferential transfers.[1]

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[1] *See, e.g.*, Ariz. Rev. Stat. § 44-1041; Ky. Rev. Stat. Ann. § 379.070; Md. Code Ann. Com. Law § 15-101; N.H. Rev. Stat. Ann. § 568:27; N.J. Stat. Ann. § 2A:19-3; N.M. Stat. Ann. §§ 56-9-1 & -2; N.Y. Debt. & Cred. Law § 15 (6-a); N.C. Gen. Stat. § 23-3); Ohio Rev. Code Ann. §§ 1313.56 & .58; 39 Pa. Cons. Stat. Ann. §§ 71, 151; S.C. Code Ann. § 27-25-20; S.D. Codified Laws § 54-9-13.2; Tenn. Code Ann. § 47-13-116; Tex. Bus. & Com. Code § 23.09; Wash. Rev. Code §§ 23.72.010 & .030 (repealed effective June 10, 2004); and Wis. Stat. § 128.07.

The Ninth Circuit majority's decision is significant because, if creditors are to have the benefit of preference recoveries, the majority's ruling forces them to forego state insolvency proceedings and instead to seek liquidation in the federal bankruptcy courts. That so many jurisdictions have incorporated preference recovery into their state law assignment procedures in order to make them more effective and fair alternatives to more cumbersome and costly federal bankruptcy procedures makes the *per se* invalidation of such statutes by the Ninth Circuit majority in this case a matter of exceptional importance to debtors and creditors, not only in California, but throughout the Nation.

B. State Voluntary Assignment Laws And Anti-Preference Provisions Have A Longstanding And Venerable History

In a voluntary assignment, "the debtor makes a voluntary transfer of all of its nonexempt assets to an assignee in trust for the purpose of liquidating the assets and distributing the proceeds to creditors on a *pro rata* basis." *See* CHARLES JORDAN TABB, *The Law of Bankruptcy* § 1.5 (1997); *see also Credit Managers Association v. National Independent Business Alliance ("CMA v. NBIA")*, 162 Cal. App. 3d 1166, 1169, 209 Cal. Rptr. 119 (1984). General assignments have been recognized by state and federal courts as being valuable tools to liquidate insolvent estates for the benefit of creditors without having to institute federal bankruptcy proceedings. *See Stellwagen v. Clum*, 245 U.S. 605, 617, 38 S. Ct. 215, 62 L. Ed. 507 (1918); *see also Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 525-26, 52 S. Ct. 262, 77 L. Ed. 469 (1933);

Johnson v. Star, 287 U.S. 527, 53 S. Ct. 265, 77 L. Ed. 473 (1933); *Mayer v. Hellman*, 91 U.S. 496, 502-03, 23 L. Ed. 377 (1875); *accord CMA v. NIBA*, 162 Cal. App. 3d at 1169. State anti-preference provisions are deeply rooted in the Nation's legal history under voluntary assignment laws. Indeed, although the Ninth Circuit majority suggests that preference recovery is a unique aspect of federal bankruptcy law, preference law in the United States actually began in the States.[2]

Anti-preference provisions serve the vital purpose of providing for the equitable distribution of a Debtor's assets by recovering transfers made to a select creditor for the distribution to the whole creditor body on a ratable basis. Absent an anti-preference statute, the assignee "stands in the place of the assignor," and cannot recover preferential payments made by the debtor-assignor prior to the assignment, because at common law the debtor-assignor himself could not have sued to recover the transfers. *See Francisco v. Aguirre*, 94 Cal. 180, 183, 29 P. 495 (1892).

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[2] Preference statutes were on the books in Massachusetts by 1838 (*see Penniman v. Cole*, 49 Mass. (8 Met.) 496 (1844)), and the "federal bankruptcy provision for avoiding preferences under the 1867 Act was borrowed from the Massachusetts Insolvency Act." *See* JOHN C. MCCOID II, *The Occasion for Involuntary Bankruptcy*, 61 AM. BANKR. L.J. 195, 199-200 & n.27 (1987). Preference statutes are of similarly ancient vintage in other states. *See, e.g., Kellogg v. Root*, 23 F. 525 (W.D. Mich. 1885); *accord Dickson v. Kittson*, 77 N.W. 820, 821 (Minn. 1899); *Teague v. Howard Grocery Co.*, 95 S.E. 173 (N.C. 1918); *In re Dairyland Inc.*, 50 Pa. D. & C. 63 (Common Pleas Lehigh Cty. 1944); *W.L. Moody & Co. v. Carroll*, 8 S.W. 510 (Tex. 1888); *Seattle Ass'n of Credit Men v. Bank of California*, 30 P.2d 972 (Wash. 1934); *Batten v. Smith*, 22 N.W. 342 (Wis. 1885).

The common-law assignee's inability to recover pre-assignment preferences may, however, be remedied by a statute expressly enabling him to seek such recovery. *See* JEANNE PHILBIN, 6 AM. JUR. 2d. *Assignments for the Benefit of Creditors* § 98 (2000). The rationale for these "anti-preference" statutes is simple: the statutes seek to avoid "preferences given just before an insolvency or liquidation," (DOUGLAS C. MICHAEL, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 KY. L.J. 937, 942 (1997)), in order to "prevent unequal treatment of the insolvent's creditors... ." BETH BATES HOLLIDAY, 42 AM. JUR. 2d, *Insolvency* § 68 (2004). The state statutes therefore "typically" provide that, "during a specified period of time before insolvency proceedings commence, any payment or transfer the debtor makes to one of his creditors in payment of a pre-existing debt may be avoided if statutory requirements or elements are met." HOLLIDAY, 42 AM. JUR. 2d § 68. Prior to the Ninth Circuit majority's decision in the instant case, such statutes had never been held to be in conflict with federal bankruptcy law. *See, e.g., Stellwagen*, 245 U.S. 605; *Pobreslo*, 287 U.S. 518; *Star*, 287 U.S. 527; *Mayer*, 91 U.S. 496; *accord CMA v. NIBA*, 162 Cal. App. 3d at 1169.

C. The Ninth Circuit Majority's Opinion Is In Direct Conflict With This Court's Test Requiring A Strong Presumption Against Preemption Of State Insolvency Laws

A "clear and manifest" intention of Congress is required for preemption of state law. *See Bates v. Dow Agrosciences, LLC*, 125 S. Ct. 1788, 161 L. Ed. 2d 687, 706, 73 U.S.L.W. 4311 (2005). A federal statute will

preempt a state statute only if the federal statute is "so pervasive as to make reasonable the inference that Congress left *no room* for states to supplement it." *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947) (*emphasis added*); *see also Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 160, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963). State statutes authorizing an assignee to void preferential transfers are not within that category.

Proceedings under state law for the liquidation of a debtor's assets and the ratable distribution of the proceeds to creditors by means of assignments for the benefit of creditors were commonplace at the time of the ratification of the United States Constitution. *See, e.g., Ogden v. Saunders*, 25 U.S. 213, 38-39, 6 L. Ed. 606 (1827). The constitutional compatibility of assignments for the benefit of creditors with federal bankruptcy law was recognized by this Court as early as 1819. *See e.g., Sturges v. Crowninshield*, 17 U.S. 122, 4 L. Ed. 529 (1819). Absent a discharge provision in a state statute, the constitutionality of state assignment statutes has been consistently upheld by this Court. *See, e.g., Stellwagen*, 245 U.S. 605; *Pobreslo*, 287 U.S. 518; *Star*, 287 U.S. 527; *Mayer*, 91 U.S. 496.

Federal bankruptcy and state assignment statutes have been structured by Congress and state legislatures to coexist and are in no sense inconsistent. Congress has made it clear by provisions of the Bankruptcy Code that it intended to preserve assignment proceedings, rather than to preempt these proceedings by federal bankruptcy laws. *See, e.g.*, 11 U.S.C. §§ 305, 543(d)(1) and (2). Congress expressly provided that assignment proceedings may, and in

some circumstances must continue, even after a bankruptcy filing.[3] Congress has also recognized that it may be appropriate for a bankruptcy court to abstain from asserting jurisdiction in favor of a state assignment proceeding if it would better serve the interests of creditors and the debtor. *See* 11 U.S.C. § 305; *see In re M. Egan Co.*, 24 B.R. 189, 191-92 (Bankr. W.D.N.Y. 1982) (motion to abstain granted where, among other things, preference recovery could be pursued in the context of an existing state-law assignment proceeding).

Neither Congress nor this Court has ever suggested that preference laws, designed to aid the equitable distribution of assets, are preempted by federal law. In *Sturges v. Crowninshield*, this Court held that "the States may ... pass laws concerning bankrupts; yet they cannot constitutionally introduce into such laws a clause which discharges the obligations the bankrupt has entered into." *See Sturges*, 17 U.S. at 199. Significantly, however, Chief Justice Marshall made clear in *Sturges* that a state insolvency statute that does *not* discharge the debtor is not preempted.

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[3] *See* 11 U.S.C. § 101(11) (defining "custodian" to include an assignee under a general assignment for the benefit of a debtor's creditors); 11 U.S.C. § 543(d)(1) (the bankruptcy court may excuse a custodian's compliance with the ordinary turnover requirements); 11 U.S.C. § 543(d)(2) (assignee in a voluntary assignment is the only type of "custodian" exempted from ordinary turnover requirements, if assignment was made more than 120 days before bankruptcy petition is filed); 11 U.S.C. § 303(h)(2) (order for relief in an involuntary bankruptcy case is not automatically entered, if voluntary assignment was made more than 120 days prior to the filing of the bankruptcy petition).

> The insolvent laws of many, indeed, of by far the greater number of the states, do not contain this principle [for discharge of the debtor]. They discharge the person of the debtor, but leave his obligation to pay in full force. *To this the constitution is not opposed.* (Italics added.)

Id. at 203; *see also Stellwagen*, 245 U.S. at 617; *Pobreslo*, 287 U.S. at 525; *Mayer*, 91 U.S. at 503. Assignment laws, such as Cal. Civ. Proc. § 1800, are insolvency statutes (as opposed to state bankruptcy laws) because they do not provide a discharge and, therefore, are not preempted by federal bankruptcy legislation.

Although, the Ninth Circuit majority appropriately recognized the overriding significance of a discharge, its holding fails logic by equating a preference statute, to one providing for a discharge. *See Sherwood*, 394 F.3d at 1203-04. (Pet. App. 9a). A preference statute, however, is not a "principle requisite of a true bankruptcy law" (as the Ninth Circuit majority appropriately characterized a discharge). A preference statute is fundamentally different than a discharge. A discharge is at the very foundation of bankruptcy law. *See Sturges* 17 U.S. at 203. Federal bankruptcy law could achieve its equitable distribution goal even if there were no provision in the Bankruptcy Code for avoiding a preferential transfer, whereas a discharge is crucial to every bankruptcy law. It does not follow that because state discharge statutes are preempted by federal bankruptcy law, state preference statutes are also preempted.

In any event, a statute authorizing state assignees the power to void preferential transfers is not an obstacle to the accomplishment of the purposes of Congress. To the contrary, such statutes are completely compatible with the purposes of Congress in enacting federal bankruptcy legislation. With regard to the equitable distribution goal of the Bankruptcy Code, voiding preferential transfers is not an end unto itself. The voiding of such transfers is merely a means to equalize distributions to creditors. The exercise of avoiding powers by either the bankruptcy trustee or an assignee supports this purpose. Despite their common goal, however, it is important that an assignee have the power under state law to void preferences because a bankruptcy case for the subject assignor, in which a trustee may void preferences, may never be commenced; and even if commenced, it may be filed too late for a trustee to collect the preference. The federal and state preference laws thus work in tandem to ensure that property transferred preferentially will not slip through the net.

California's anti-preference provision was intended to align state law and federal bankruptcy law and "is, by design, virtually identical to the Bankruptcy Code's preferential transfer statute." *See Sherwood*, 394 F.3d at 1207; *see also Angeles Electric Co. v. Superior Court*, 27 Cal. App. 4th 426, 430-31, 32 Cal. Rptr. 2d 660 (1994) (discussing intentional conformance of section 1800 with federal bankruptcy law). (Pet. App. 19a). As such, Cal. Civ. Proc. Code § 1800 is interpreted in light of case law addressing Bankruptcy Code § 547. *See Blonder v. Cumberland Eng'g*, 71 Cal. App. 4th 1057, 1061, 84 Cal. Rptr. 2d 216 (1999). As the dissent points out, Cal. Civ. Proc. Code § 1800 and

Bankruptcy Code § 547 both serve and are consistent with the goal of equitable distribution. *Sherwood*, 394 F.3d at 1207-08 (Pet. App. 19a to 20a). "That California's voluntary assignment system has such a provision [Cal. Civ. Proc. Code § 1800] makes it more capable of effecting the equality of distribution that is the aim of bankruptcy law; it does not necessarily interfere with bankruptcy's goal of achieving equal distribution." *See Sherwood*, 394 F.3d at 1208. (Pet. App. 20a). As the dissent further states, "the nature of the regulated activity – distribution of the debtor's assets [and furthering the goal of equitable distribution]" – is not one rendering it impossible to conclude that the state and federal systems can peaceably coexist. *See Sherwood*, 394 F.3d at 1208. (Pet. App. 21a).

D. The Ninth Circuit Majority's *Sub Silentio* Promotion Of State Anti-Preference Laws That Encourage Individual Creditor Action Runs Contrary To The Recognized Purposes Of The Bankruptcy Code

As the Ninth Circuit majority observes, one of the primary goals of the Bankruptcy Code is to ensure equality of distribution of an insolvent debtor's assets among all creditors. *See Sherwood*, 394 F.3d at 1203. (Pet. App. 7a). However, the Ninth Circuit majority's ruling in this case promotes the opposite result. The Ninth Circuit majority's reading of *Stellwagen v. Clum*, 245 U.S. 605, as approving state anti-preference statutes so long as the recovery power "could have been exercised by any creditor" is an invitation to state legislatures to provide for exactly that. *See Sherwood*, 394 F.3d at 1205, *citing Stellwagen*, 245 U.S. 605, 611,

n.1. (Pet. App. 12a). However, the effect of such state statutes would be to promote *inequality* in payments to creditors by an insolvent debtor's assignment estate. If an individual creditor could file an action against another creditor who received a preferential transfer and recover that payment for itself, whichever creditor first succeeded in obtaining a judgment against another would potentially satisfy its claim in a greater percentage than other creditors. Such an inequitable result would force creditors to elect bankruptcy as their only option.

The Ninth Circuit majority's silence on what would permissibly happen to such creditor recoveries is telling. Is the recovering creditor protected against further preference recovery suits by yet a third creditor, or is litigation possible, too, against those who have recovered a preference? The "destructive feeding frenzy by creditors" condemned by the Ninth Circuit majority, could be mild compared to a scenario of individual creditor's suits to recover preferences that would inject turmoil into the judicial system. *See Sherwood*, 394 F.3d at 1203. (Pet. App. 9a).

The other, more likely, outcome is that debtors and creditors will be driven away from the less expensive, less cumbersome insolvency solutions historically provided by state law, and forced into the Bankruptcy Court. If the state law tool to achieve equitable distribution through a general assignment for benefit of creditors is "preempted," debtors and creditors will have no choice but to take insolvencies into bankruptcy, voluntarily or involuntarily, to obtain an equitable distribution. The Ninth Circuit majority offers no reason why this departure from decades of

insolvency practice is warranted, sound, or even feasible.

E. The Ninth Circuit Majority's Opinion Could Undermine The Commercial Laws Of All Fifty States

Under the Ninth Circuit majority's reasoning, the laws of all 50 states adopting Uniform Commercial Code provisions that authorize an assignee to avoid an unperfected security interest as a "lien creditor," could be preempted because the same avoidance powers are not granted to all individual creditors.[4] *See, e.g.*, Cal. Com. Code §§ 9102(a)(52)(ii) and 9317(a) (Supp. 2005). Moreover, under the majority's reasoning, state laws that allow an assignee (and not an individual creditor) to avoid liens obtained prior to the commencement of a voluntary assignment could likewise meet the same fate of federal preemption. *See, e.g.*, Cal. Civ. Proc. Code § 493.030 (Supp. 2005). Additionally, the majority's decision could be read to preempt state laws that govern distribution to creditors. All of these provisions effect the equitable distribution of the assets of an insolvent entity, which the Ninth Circuit majority erroneously held can only be a subject of federal bankruptcy law.

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[4] Uniform Commercial Code §§ 9-102 and 9-317 have been adopted by each state and the territories of Puerto Rico, Guam and the Virgin Islands. All states, except for Louisiana and the territory of Puerto Rico, have adopted the definition of a lien creditor set forth in California law. *See, e.g.*, Cal. Com. Code §§ 9102(a)(52)(ii) and 9317(a).

II. THE NINTH CIRCUIT MAJORITY OPINION IS IN DIRECT CONFLICT WITH THE GOVERNING DECISIONS OF THIS COURT INVOLVING STATE ANTI-PREFERENCE STATUTES

A. This Court's Decisions In *Pobreslo* And *Star* Each Involved Anti-Preference Statutes Providing The Assignee With Avoiding Powers Beyond Those Available To Individual Creditors

The Ninth Circuit majority's assumption that California's voluntary assignment proceedings involving Cal. Civ. Proc. Code § 1800, by granting an assignee an avoidance power not held by individual creditors, was somehow unique and distinguishable from the assignment procedures previously upheld by this Court is demonstrably false. The Wisconsin statute at issue in this Court's decision in *Pobreslo*, 287 U.S. 518, and the Texas statute at issue in *Star*, 287 U.S. 527, like that of California and many other jurisdictions today, incorporated a preference avoidance power to be exercised solely by assignees and were upheld by this Court against preemption attack. *See In re Wisconsin Builders Supply ("Wisconsin Builders")*, 239 F.2d 649, 654-55 (7th Cir. 1956).

Pobreslo and *Star* each involved, like Cal. Civ. Proc. Code § 1800, state anti-preference statutes that: (1) are only triggered upon the commencement of a voluntary assignment; (2) only authorize an assignee (and not an individual creditor) to commence an action; (3) authorize an individual creditor to commence an

action only if the assignee fails to commence an action within a specified time period and, then, only in the name and for the benefit of the assignee; and (4) if any action is brought by a creditor after the assignee declines or fails to timely do so, then any recovery must be delivered to the assignee for equitable distribution to creditors. In *Pobreslo*, this Court upheld Wisconsin's voluntary assignment statute codified at Wis. Stat. § 128, *et seq.* (1929). *See Pobreslo*, 287 U.S. at 525-26. The anti-preference provision in that statute reads:

> [t]he assignee shall possess all the power necessary to institute any action or proceeding to set aside and avoid any levy, sale, mortgage, hypothecation, lien or other security made, given or executed contrary to the provisions of the preceding section [setting forth the elements of a preferential transfer]. If the assignee shall neglect for sixty days after the execution of the assignment to institute an action or proceeding as herein provided any creditor of the assignor who has duly proved his claim ... may institute and prosecute to judgment any such action or proceeding in the name of the assignee and for his benefit, upon executing to the latter a bond ... .

See Wis. Stat. §§ 128.02, 128.03 (1929).[5] In *Wisconsin Builders*, the Seventh Circuit Court of Appeals revisited and upheld the Wisconsin's voluntary

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[5] The modern version of Wisconsin's anti-preference statute has not materially changed since the *Pobreslo* decision. *See* Wis. Stat. § 128.07 (2004).

assignment statute that was upheld in *Pobreslo*, as amended in 1937 and 1939, and concluded that a "comparison of the provisions of Chapter 128 [containing the anti-preference provisions] with those of the prior act [the statute in *Pobreslo*] compels a conclusion that Chapter 128 ... is substantially a re-enactment of the earlier law." *See Wisconsin Builders*, 239 F.2d at 656. Finally, in 1977, Wisconsin's assignment statutes, which had been revised yet again in 1957, but still contained a preference recovery provision, were once again challenged on preemption grounds, and once again upheld. *See Gelatt v. DeDakis* (*"In re Assignment for Benefit of Creditors of Mader's Store for Men, Inc."*), 254 N.W. 2d 171 (Wis. 1977). The statutes, the court explained, did not purport to grant the debtor a discharge, and neither "created nor permitted" any "improper interference with the operation of" the Bankruptcy Act. *Id.* at 182.

In *Star*, this Court upheld Texas' voluntary assignment statute. The anti-preference provision in that statute reads:

> [a]ll property conveyed or transferred by the assignor ... [that] give[s] preference to one creditor over another, shall pass to the assignee by the assignment ... and the assignee, or in case of his neglect or refusal, any creditor or creditors may in his name sue for, recover and collect the same, and cause the same to be applied for the benefit of creditors as other property belonging to the debtor's estate in the hands of the assignee.

See Vernon's Ann. Civ. St. Art. 268.[6]

The Ninth Circuit majority opinion does not mention *Star* or *Wisconsin Builders*, or the anti-preference statutes involved in those cases. Further, the Ninth Circuit majority misperceives the anti-preference statute in existence in *Pobreslo*, stating "[t]he statute we confront here goes further, giving the state assignee entirely new powers [that are not available to all creditors] that are not derived from contract and trust law." *See Sherwood*, 394 F.3d at 1206. (Pet. App. 16a). However, under the anti-preference statutes in *Pobreslo* and *Star*, if the anti-preference action is timely brought by the assignee, then no creditor can bring the action. Therefore, according to the Ninth Circuit majority's reasoning, the anti-preference statutes in *Pobreslo* and *Star* would be unconstitutional. Accordingly, Ninth Circuit's ruling that the California anti-preference statute is preempted by federal bankruptcy law is in direct conflict with this Court's precedent.

B. The Ninth Circuit Majority's Preemption Holding Is Based On A Fatally Flawed Effort To Distinguish This Court's *Stellwagen* Decision

In distinguishing this Court's decision in *Stellwagen v. Clum*, the Ninth Circuit majority, citing to footnote 1 of the *Stellwagen* decision, states that "the

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[6] The modern version of Texas' anti-preference statute has not materially changed since the *Johnson v. Star* decision. *See* Tex. Bus. & Com. Code § 23.09 (2004).

Supreme Court in *Stellwagen* did uphold a statute that allowed a state trustee to recover preferential transfers, but the preferential avoidance power the trustee exercised in that case was one that could have been exercised by any creditor." *See Sherwood*, 394 F.3d at 1205. (Pet. App. 12a to 13a). The Ninth Circuit majority's preemption holding depends, therefore, on distinguishing this Court's decision in *Stellwagen*. In attempting to distinguish *Stellwagen*, however, the Ninth Circuit majority misunderstood that case and the Ohio statute upheld by this Court.

In *Stellwagen*, this Court held the Bankruptcy Act did *not* preempt an Ohio anti-preference statute that permitted the recovery of property transferred by a debtor assignor in contemplation of insolvency and with a design to prefer one or more creditors to the exclusion of others.[7] *See Stellwagen*, 245 U.S. at 616-618. Like the insolvency laws of more than a dozen other states, including California, the Ohio statutory scheme at issue in *Stellwagen* invests assignees and trustees with greater authority than that possessed by any single creditor. The Ohio statutes, thus, set up a two-step process. In the first, a creditor acts to have a transfer declared void. In the second, and key, step under the statutes -- the recovery of the transferred property and its administration for the benefit of all creditors -- only a receiver or trustee acting on behalf of all creditors can sue to recover the transferred

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[7] The Ohio statute, Revised Statutes of Ohio, §§ 6343 and 6344 (1908), were renumbered in the General Code of Ohio of February 15, 1910 as §§ 11102 to 11107. The exact text of the statute appears in *Stellwagen v. Clum*, at 245 U.S. at 609, n.1.

property "*as in other cases of assignments to trustees for benefit of creditors.*" *See* Ohio Rev. Stat. § 6344. (*emphasis added*). The Bankruptcy Code, itself, recognizes this distinction between determining whether a transfer is void and recovering such a void transfer for the benefit of all creditors. *See* 11 U.S.C. § 547 (allowing a trustee to avoid transfers under the circumstances described in the section); *see also* 11 U.S.C. § 550 (providing the authority for the trustee to sue to recover the transfer).

The Ohio statutes first provide that when a transfer meets the statutory criteria, then:

> ... at the suit of any creditor or creditors, and in any suit brought by any creditor or creditors of such debtor or debtors for the purpose of declaring such sale void, a receiver may be appointed who shall take charge of all the assets of such debtors including the property so sold, conveyed, transferred, mortgaged or assigned, which receiver shall administer all the assets of the debtor or debtors for the equal benefit of the creditors of the debtor or debtors in proportion to the amount of their respective demands, including those which are unmatured.

See Ohio Rev. Stat. § 6343. The Ohio statutes further provide that:

> ... any creditor or creditors as to whom any of the acts or things prohibited in the preceding are void ... may commence an action in a court of competent jurisdiction to have such acts or things declared void. And such court shall

> appoint a trustee or receiver according to the provisions of this chapter, who upon being duly qualified shall proceed by due course of law to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned and to administer the same for the equal benefit of all creditors as in other cases of assignments to trustees for the benefit of creditors.

See Ohio Rev. Stat § 6344. As a close reading of these statutes demonstrates, there is a significant distinction between determining the invalidity of a transfer that may be voided, on the one hand, and the recovery of the transfer for the benefit of all creditors of the transferor, on the other hand – a distinction the Ninth Circuit majority failed to recognize. No provision of the Ohio statutes at issue in *Stellwagen* authorizes a creditor to act independently to recover transferred property, whether for its own benefit or for all the creditors' benefit. *See, e.g., Philips v. The Ammon-Stevens Co.*, 3 Ohio Dec. 418 (Ohio Com. Pl. 1895). Additionally, both Ohio statutes provide that any creditor can bring an action to declare a transfer void, but in both cases, the mandatory consequence of such a decision is the appointment of a receiver or trustee. *See* Ohio Rev. Stat. §§ 6343 and 6344.

The Ninth Circuit majority erred in stating that the anti-preference powers granted under the Ohio statutes "could have been exercised by any creditor." *See Sherwood*, 394 F.3d at 1205. (Pet. App. 12a). The Ohio statutes authorize no such thing. *See, e.g., Stellwagen*, 245 U.S. at 618. Moreover, the Ohio statutes expressly recognize the authority of assignees to recover transferred property for the benefit of all

creditors. This is the exact authority that general assignees are granted under Cal. Civ. Proc. Code § 1800. The Ohio statutes at issue in *Stellwagen* are directly parallel to the California statute at issue here. Therefore, this Court's *Stellwagen* decision is binding precedent, and the Ninth Circuit majority's opinion, that Cal. Civ. Proc. Code § 1800 is preempted by federal bankruptcy law, conflicts with *Stellwagen*.

C. Even Assuming That The Test For Validity Of A State Anti-Preference Statute Is Whether A Single Creditor, Alone, Can Sue, California's Law Also Meets That Test

Even assuming that the Ninth Circuit majority's analysis of *Stellwagen* is correct, and that state anti-preference statutes that allow the preference recovery power to any one creditor are not preempted by the Bankruptcy Code, California law meets that test. It is well established under California law that an assignee for the benefit of creditors is a trustee for the benefit of the assignor's creditors, not just a custodian for the assignor. *See, e.g., Brainard v. W. J. Fitzgerald*, 3 Cal. 2d 157, 163, 44 P.2d 336 (1935); *see also Mechanics Bank of Richmond v. M. H. Rosenberg*, 201 Cal. App. 2d 419, 424, 20 Cal. Rptr. 202 (1962).

Likewise, under California law, where a trustee of a trust cannot or will not enforce a valid cause of action that the trustee should bring against a third person, a beneficiary of the trust may seek judicial compulsion against the trustee by suing directly and joining the trustee and the liable third party as defendants. *See Saks v. Damon Raike & Company*, 7

Cal. App. 4th 419, 426-30, 8 Cal. Rptr. 2d 869 (1992); *see also Triplett v. Williams*, 269 Cal. App. 2d 135, 137-38, 74 Cal. Rptr. 594 (1969); *accord Women's Athletic Club v. Anglo California National Bank*, 90 Cal. App. 2d 850, 852, 204 P.2d 411 (1949); *Restatement (2d) of Trusts*, § 282. Because an assignee for the benefit of creditors is a trustee, the failure of the assignee to pursue an anti-preference claim under Cal. Civ. Proc. Code § 1800 activates the right of a creditor, as a beneficiary of the assignment trust, to initiate such action, and thereby join the assignee as a party defendant. Any recovery, of course, would inure to the benefit of all creditors because, as in the case of the Ohio statutes validated in *Stellwagen*, the recovery is through the assignment estate. *See Stellwagen v. Clum*, 245 U.S. at 619. Accordingly, California's common law and Cal. Civ. Proc. Code § 1800, taken together, provide for a procedural result exactly parallel with the Ohio statutes *Stellwagen* held were not preempted. The only difference is that California law supplies the beneficiary's right to sue through a non-statutory legal principle. But this is a difference without consequence because California draws no distinction between its statutory and common law – both are sources of the state's law. *See* Cal. Civ. Code § 22.2.

D. By Definition, Voluntary Assignments Are Collective Proceedings Designed To Achieve Equitable Distribution And Are In Harmony With Federal Bankruptcy Law

The underlying basis for the Ninth Circuit majority's ruling is the majority's clear preference for invoking the machinery of the federal bankruptcy

system over the less cumbersome state law remedy of a voluntary assignment. The Ninth Circuit majority's bias favoring the federal bankruptcy system over that of state voluntary assignments is unprecedented. As stated in the dissent, "the Supreme Court ... has never suggested that state laws that regulate the distribution of assets in a voluntary assignment might face the same fate [as unconstitutional discharge provisions]." *See Sherwood*, 394 F.3d at 1207. (Pet. App. 18a).

The Ninth Circuit majority acknowledges that voluntary assignments are a "venerable" and valid state law alternative to federal bankruptcy proceedings, were upheld by this Court in *Pobreslo*, and were expressly contemplated in the Bankruptcy Code to coexist with federal bankruptcy proceedings. *See Sherwood*, 394 F.3d at 1201, 1206. (Pet. App. 4a, 15a to 16a). Nevertheless, the Ninth Circuit strikes down California's anti-preference law because it furthers the same goal of bankruptcy law to promote equality of distribution. This logic is simply not sound. *See Sherwood*, 394 F.3d at 1207. (Pet. App. 19a). Further, in *Pobreslo*, this Court held that Wisconsin's statute was "...in harmony with the purposes of the federal [bankruptcy] act ..., served to protect creditors against each other and goes to assure equality of distribution." *See Pobreslo*, 287 U.S. at 525. Therefore, the Ninth Circuit majority's ruling is in direct conflict with this Court's precedent in *Pobreslo* that state law provisions promoting equality of distribution to creditors do not conflict with federal bankruptcy law. As the dissent points out, although the Ninth Circuit majority acknowledges that this Court has repeatedly upheld voluntary assignments as a valid state law alternative to federal bankruptcy proceedings, "[t]he majority's

concerns about section 1800 are not distinguishable from concerns about voluntary assignment provisions generally." *See Sherwood*, 394 F.3d at 1206. (Pet. App. 19a). In summary, the majority's preference for federal bankruptcy proceedings over state law assignment provisions that are designed to promote the equitable distribution of an insolvent debtor's assets is in direct conflict with this Court's governing precedent.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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No. 03-55247

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,
Plaintiff-counter-defendant-Appellee,

v.

LYCOS, INC., a Delaware Corporation aka Delaware Lycos, Inc.,
Defendant-counter-claimant-Appellant.

June 8, 2004, Argued and Submitted, Pasadena, California
January 12, 2005, Filed

COUNSEL: James S. Monroe and Walter T. Johnson, Nixon Peabody LLP, San Francisco, California, for the defendant-appellant.

Irving Sulmeyer and Janis G. Abrams, SulmeyerKupetz, Los Angeles, California, for the plaintiff-appellee.

JUDGES: Before: Dorothy W. Nelson, Alex Kozinski and Susan P. Graber, Circuit Judges. Opinion by Judge Kozinski; Dissent by Judge D.W. Nelson.

OPINIONBY: Alex Kozinski

OPINION: KOZINSKI, Circuit Judge:

We consider whether the Bankruptcy Code preempts a state statute that gives an assignee selected by the debtor the power to void preferential transfers that could not be voided by an unsecured creditor.

Facts

Thinklink Corp., a unified messaging service provider, entered into an agreement with Lycos, which operates a network of web sites. Lycos agreed to promote Thinklink's messaging service on Lycos web sites exclusively for two years. Thinklink eventually defaulted on one of its payments; Lycos nevertheless continued to display links to Thinklink's messaging service. Lycos and Thinklink renegotiated their agreement, shortening the exclusivity period to 90 days and reducing Thinklink's remaining payments from over $ 17 million to $ 1 million plus stock. Thinklink delivered the $ 1 million but not the stock, and about two months later made a voluntary general assignment for the benefit of creditors to Sherwood Partners. Sherwood shut down Thinklink's business and sued Lycos in state court under Cal. Civ. Proc. Code § 1800 to recover the $ 1 million payment as a preferential transfer.[1]

Lycos removed to federal court on diversity grounds and moved to dismiss, arguing that section 1800 was preempted by the Bankruptcy Code. The district court denied Lycos's motion and eventually granted summary judgment to Sherwood. Lycos appeals.

Discussion

Congress has broad authority to preempt state laws,

but whether Congress has done so in a particular instance is a matter of congressional intent. This intent is most easily detected where the statute expressly preempts other laws, but preemption may also be inferred where it is clear from the statute and surrounding circumstances that Congress intended to occupy the field, leaving no room for state regulation. The Supreme Court, in Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission, 461 U.S. 190, 75 L. Ed. 2d 752, 103 S. Ct. 1713 (1983), summarized the contours of the field preemption doctrine:

Absent explicit pre-emptive language, Congress' intent to supersede state law altogether may be found from a "'scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it,' because 'the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject,' or because 'the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose.'"

Id. at 203-04 (quoting Fid. Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U.S. 141, 153, 73 L. Ed. 2d 664, 102 S. Ct. 3014 (1982) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 91 L. Ed. 1447, 67 S. Ct. 1146 (1947))). "Even where Congress has not entirely displaced state regulation in a specific area," the Court continued, "state law is pre-empted . . . where [it] 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of

Congress.'" Id. at 204 (quoting Hines v. Davidowitz, 312 U.S. 52, 67, 85 L. Ed. 581, 61 S. Ct. 399 (1941)).

There can be no doubt that federal bankruptcy law is "pervasive" and involves a federal interest "so dominant" as to "preclude enforcement of state laws on the same subject"--much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and immigration. The Bankruptcy Clause, which grants Congress the power to make bankruptcy laws, U.S. Const. art. I, § 8, cl. 4, stresses that such rules must be "uniform." Bankruptcy law occupies a full title of the United States Code. It provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees.

At the same time, federal law coexists peaceably with, and often expressly incorporates, state laws regulating the rights and obligations of debtors (or their assignees) and creditors. See, e.g., 11 U.S.C. § 522(b)(2) (incorporating state personal exemptions to the bankruptcy estate); Id. § 544(b) (making state law on voidable transfers available to the bankruptcy trustee); Id. § 543(d)(2) (excusing some assignees for the benefit of creditors from compliance with property turn-over requirements). In determining whether Cal. Civ. Proc. Code § 1800 is preempted, we must consider whether it is merely another creditor rights provision of the kind that is tolerated by the Bankruptcy Code, or whether it gives the state assignee powers that are within the heartland of bankruptcy administration.

Sherwood argues that the preference avoidance provisions of section 1800 are not only tolerated but specifically incorporated by the Bankruptcy Code through section 544(b), which allows a bankruptcy trustee to avoid any transfers voidable by unsecured creditors under "applicable law" (including state law).[2] Section 544(b), says Sherwood, "manifest[s] congressional intent not to preempt state statutes invalidating preferences. . . . Empowering bankruptcy trustees to so act a fortiori manifests a congressional intent that state statutes are valid and available to be used by a bankruptcy trustee." Reply Br. of Appellee at 30. The Supreme Court in Stellwagen v. Clum, 245 U.S. 605, 62 L. Ed. 507, 38 S. Ct. 215 (1918), in fact cited section 70e of the Bankruptcy Act of 1898, the precursor to section 544(b), in upholding a statute allowing assignees to void certain preferential transfers. See Id. at 614, 618.

But the trustee's powers under section 544(b) are limited to those of unsecured creditors--such as the right of an individual unsecured creditor to set aside fraudulent conveyances under state law. See, e.g., Decker v. Advantage Fund Ltd., 362 F.3d 593, 596 (9th Cir. 2004) (involving a claim, under section 544(b), to avoid a transfer using California's Uniform Fraudulent Transfer Act, Cal. Civ. Code § 3439.04). Similarly, the Ohio statute upheld in Stellwagen, unlike the California statute at issue here, gave court-appointed trustees only those avoidance powers already held by "any creditor or creditors." 245 U.S. at 611 n.1 (quoting the statute).[3] By contrast, the power to set aside preferential transfers under California's section 1800 can be exercised only by general assignees, not by individual unsecured creditors. In other words, the

assignee appointed pursuant to section 1800 is given new avoidance powers by virtue of his position.

To make Stellwagen and section 544(b) cover this case would require us to read the term "creditor" in section 544(b) as encompassing representatives of creditors such as Sherwood. We doubt that Congress had Sherwood in mind when describing unsecured creditors in section 544(b). The Bankruptcy Code defines "creditor," in relevant part, as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. § 101(10)(A). "Custodian" is a different concept, which includes receivers, trustees and "assignee[s] under a general assignment for the benefit of the debtor's creditors." Id. § 101(11). In fact, Congress defined custodian using the word "creditor" in two places. See Id. § 101(11)(B), (C). Custodians, instead of being by their nature creditors, stand in a certain fiduciary relation to creditors. But Congress did not mention custodians alongside creditors in section 544(b). We are therefore unable to read "creditor" in section 544(b) to include custodians. See Dubis v. B.W. Supply (In re Delta Group), 300 B.R. 918, 923-24 (Bankr. E.D. Wis. 2003); 5 Collier on Bankruptcy P 544.09[4], at 544-21 & n.26 (Lawrence P. King et al. eds., 15th ed. rev. 2004) ("creditor" in section 544(b) includes assignees or successors of the original creditor, but "an assignee for the benefit of creditors . . . is not such a creditor"); see also In re Komfo Prods. Corp., 247 F. Supp. 229, 237 (E.D. Pa. 1965); Vern Countryman, The Use of State Law in Bankruptcy Cases (Part II), 47 N.Y.U. L. Rev. 631, 663 (1972) (if Congress intended "any creditor" in section 70e, the precursor to section 544(b), to mean "any representative of any creditor," "it

would be desirable to amend [the statute] to say so"). Contra Zimmerman v. Frem Corp. (In re Kenval Mktg. Corp.), 69 B.R. 922, 929-31 (Bankr. E.D. Pa. 1987).[4] Thus, section 544(b) of the Bankruptcy Code, and its partial incorporation of state transfer avoidance law, does not save the California statute from preemption.

The question remains whether the section 1800 assignee's special avoidance powers, though not expressly incorporated into the Bankruptcy Code by section 544(b), nevertheless can peaceably coexist with the federal bankruptcy scheme. To answer this question we must consider the essential goals and purposes of federal bankruptcy law, and then determine whether section 1800 is consistent with them.

It is generally agreed that chapter 7 of the Bankruptcy Code, which governs liquidations, embodies two ideals: (1) giving the individual debtor a fresh start, by giving him a discharge of most of his debts; and (2) equitably distributing a debtor's assets among competing creditors. See Stellwagen, 245 U.S. at 617. As the leading bankruptcy treatise explains, these two goals are separate and operate somewhat independently of each other:

From the creditors' viewpoint, chapter 7 establishes the concept of equitable distribution among creditors of a debtor's resources which, in most cases, are insufficient to permit full payment to all. From the individual debtor's vantage point, chapter 7 permits the honest debtor to obtain a new financial life through the discharge of unpaid debts. Neither concept is dependent on the other. Thus, in many chapter 7 cases,

which may also be called "no-asset" cases, the debtor has no property realizable by creditors. Nevertheless, unless the debtor has committed [certain acts, he] is entitled to a full discharge and release from all debts except those rendered nondischargeable . . . . The distribution to creditors is also not affected by whether or not the debtor obtains a discharge. Should discharge be denied, and property exists in the chapter 7 estate available to creditors, distribution will occur.

1 Collier on Bankruptcy P 1.03[2][a], at 1-22 (emphasis added) (footnotes omitted).

We know, because the Supreme Court has repeatedly told us, that state statutes that purport to perform the first of these functions, by giving debtors a discharge of their debts, are preempted. See Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265-66, 73 L. Ed. 318, 49 S. Ct. 108 (1929); see also Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 525, 77 L. Ed. 469, 52 S. Ct. 262, 53 S. Ct. 262 (1933); Stellwagen, 245 U.S. at 615-16. That the state discharge statute may be compatible with (or even identical to) the federal discharge statute makes no difference. Nor does it matter that a creditor may be able to opt out of the state insolvency proceeding by commencing an involuntary federal bankruptcy proceeding; indeed, according to Stellwagen, it does not even matter whether a federal bankruptcy act is in effect. Id. at 615 ("It is settled that a State may not pass an insolvency law which provides for a discharge of the debtor from his obligations, which shall have the effect of a bankruptcy discharge as to creditors in other States, and this although no general federal bankruptcy act is in effect."). Such state procedures are preempted simply because the ability to grant a discharge is "one

of the principal requisites of a true bankruptcy law." Id. at 616.

What goes for state discharge provisions also holds true for state statutes that implicate the federal bankruptcy law's other major goal, namely equitable distribution. Bankruptcy law accomplishes equitable distribution through a distinctive form of collective proceeding. This is a unique contribution of the Bankruptcy Code that makes bankruptcy different from a collection of actions by individual creditors. In a world of individual actions, each creditor knows that if he waits too long, the debtor's assets will have been exhausted by the demands of the quicker creditors and he will recover nothing. The creditors race to the courthouse, all demanding immediate payment of their entire debt. Like piranhas, they make short work of the debtor, who might have survived to pay off more of his debts with a little bit of reorganization--or at least might have more equitably fed the slower piranhas. See, e.g., In re Hoskins, 102 F.3d 311, 316 (7th Cir. 1996) (noting the Bankruptcy Code's purpose of "preventing a mutually destructive feeding frenzy by creditors"), rev'd on other grounds, Assoc. Comm. Corp. v. Rash, 520 U.S. 953, 965, 138 L. Ed. 2d 148, 117 S. Ct. 1879 (1997); In re Kish, 41 B.R. 620, 624 (Bankr. E.D. Mich. 1984) (describing the "piranha-like attacks of creditors"). Don't see Piranha (New World Pictures 1978). But see Berger v. Piranha, Inc. (In re Piranha, Inc.), 297 B.R. 78 (N.D. Tex. 2003) (a case where the creditors got the Piranha).

Federal bankruptcy law seeks to avoid this scenario by "creating a whole system under federal control which is designed to bring together and adjust all of the rights and duties of creditors and embarrassed debtors alike."

MSR Exploration, Ltd. v. Meridian Oil, Inc., 74 F.3d 910, 914 (9th Cir. 1996). The filing of a bankruptcy petition brings a bankruptcy estate into being and triggers an automatic stay, which prevents creditors from enforcing their claims, thus preserving the debtor's assets for ultimate distribution by the bankruptcy trustee. See 11 U.S.C. §§ 301-303, 362; see also 1 Collier on Bankruptcy P 1.03[2][b], at 1-24 to 1-25.

One of the major powers the Code gives the trustee is the power to avoid preferential transfers.[5] The trustee is authorized to recover these sums for the use of the bankruptcy estate in making its distribution to creditors. Of course, this power, like all others, may be exercised only under the supervision of the federal courts; and the trustee exercising those powers to liquidate a corporation is not hand-picked by the debtor, as was Sherwood, but appointed and supervised by the United States Trustee, an official of the Department of Justice, see 11 U.S.C. § 701, or elected by the creditors, see Id. § 702, to ensure impartiality. Federal law protects creditors--particularly out-of-state creditors like Lycos--from the trustee's possible conflicts of interest and other possible sources of self-dealing, see Id. § 327 (regulating what professionals a trustee may employ); Id. § 328 (regulating the compensation of such professionals); Fed. R. Bankr. P. 2014 (regulating employment of professionals), and generally provides extensive disclosure, see Fed. R. Bankr. P. 1007, 2016, 9019.

It is clear that if a state assignee under section 1800 recovers a preferential transfer and distributes its proceeds to creditors, this will preclude a federal

trustee from recovering the same sum under the federal preference statute if a federal bankruptcy proceeding is begun. The creditor who disgorged the transfer cannot disgorge it twice; the creditors who later received the recovered money may be impossible to identify; and even if they can be identified, they may be gone or in financial difficulty themselves. The distribution of the recovered sum will then have been made by a state assignee subject to state procedures and substantive standards, rather than by the federal trustee subject to bankruptcy law's substantive standards and procedural protections.[6]

Sherwood points out that the creditor may be able to avoid this result by quickly filing an involuntary federal bankruptcy petition, which would have the effect of preempting the state proceedings. But this argument proves too much. The same would be true of a state statute that purported to give debtors a discharge: Creditors in that situation could presumably also avoid the effect of state law by bringing a federal petition. Yet the Supreme Court has stated unequivocally that such state statutes are preempted. See page 427 supra.

In any event, the affected creditor (like Lycos) may not be able to run to federal court because in most cases (i.e., those where there are more than eleven creditors) at least three creditors are required to force the debtor into bankruptcy. 11 U.S.C. § 303(b)(1). And the action of the state assignee may diminish the likelihood that Lycos will be able to obtain the consent of other creditors. After all, if the state assignee succeeds in recovering the preferential transfer under state law, the other creditors may share in that bounty and might

therefore have no interest in invoking the potentially more expensive and time-consuming federal processes.

This points to yet another vice of the state proceedings: Once they are commenced, they will affect the incentives of various parties as to whether they wish to avail themselves of federal bankruptcy law. The creditor whose ox is being gored by the state assignee may have a new incentive to begin an involuntary federal proceeding; other creditors, for the reasons explained above, may have diminished incentives. The provisions of the Bankruptcy Code, including those that explicitly incorporate certain state laws (like voluntary assignments, or preference recovery provisions available to unsecured creditors) carefully delineate the circumstances under which federal bankruptcy proceedings are to be initiated. We do not believe Congress contemplated state laws that would sharpen or blunt the effect of those statutory incentives.[7]

Stellwagen, on which Sherwood relies heavily, is not to the contrary. As noted above, see pages 424-26 supra, the Supreme Court in Stellwagen did uphold a statute that allowed a state trustee to recover preferential transfers, but the preferential avoidance power the trustee exercised in that case was one that could have been exercised by any creditor. 245 U.S. at 611 n.1. While the Court in Stellwagen reiterated that a state statute granting a discharge would definitely be preempted, it left open whether other state statutes dealing with the subject of insolvency may also be preempted. Id. at 616. We believe that statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the

federal bankruptcy power.[8] Congress has thought carefully about how collective insolvency proceedings are to be conducted and set both substantive standards and elaborate procedural protections to ensure a result that is fair to debtors and creditors alike. The exercise of the preference avoidance power by Sherwood under the authority of section 1800 is inconsistent with the enactment and operation of the federal bankruptcy system and is therefore preempted.

Conclusion

Because we hold that the California statute, Cal. Civ. Proc. Code § 1800, is preempted by the Bankruptcy Code, we remand to the district court for dismissal of the complaint.

REVERSED.

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - -

n1 The statute provides that:

The assignee of any general assignment for the benefit of creditors . . . may recover any transfer of property of the assignor:

(1) To or for the benefit of a creditor;

(2) For or on account of an antecedent debt owed by the assignor before the transfer was made;

(3) Made while the assignor was insolvent;
(4) Made on or within 90 days before the date of the making of the assignment . . .; and

(5) That enables the creditor to receive more than another creditor of the same class.

Cal. Civ. Proc. Code § 1800(b).

n2 Section 544(b) provides, in relevant part, that "the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim." 11 U.S.C. § 544(b).

n3 The state statute at issue in Stellwagen was not a true preference statute, like Cal. Civ. Proc. Code § 1800 and 11 U.S.C. § 547, in that it required that the transfer have been made in contemplation of insolvency or with an intent to defraud creditors, making it more akin to a fraudulent conveyance statute. This distinction does not make a difference for purposes of our analysis.

n4 We note that the Supreme Court, frowning on extending the meaning of statutory terms for policy reasons, has recently declined to read "trustee" in 11 U.S.C. § 506(c) as including administrative claimants. See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 14, 147 L. Ed. 2d 1, 120 S. Ct. 1942 (2000). The Court reiterated that "when the statute's language is plain, the sole function of the courts . . . is to enforce it according to its terms." Id. at 6 (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989) (quoting Caminetti v. United States, 242 U.S. 470, 485, 61 L. Ed. 442, 37 S. Ct. 192 (1917))) (internal quotation marks omitted).

n5 The trustee may avoid preferences either under 11 U.S.C. § 547(b) or under state law (as incorporated into the Bankruptcy Code by section 544(b)) to the extent such transfers could be voided by an unsecured creditor.

n6 This is not a matter for federal concern when the assignee has no special avoidance rights. If individual unsecured creditors can sue to recover preferences under state law, the same powers are also available to a bankruptcy trustee under section 544(b); there is obviously no conflict then between federal law and state law giving those powers to an assignee. To the extent a state assignee, who is less procedurally constrained than a bankruptcy trustee, may be free to engage in self-dealing, he can do nothing more than individual creditors, who are free to engage in all the self-dealing they want.

n7 Perkins v. Petro Supply Co. (In re Rexplore Drilling, Inc.), 971 F.2d 1219, 1222 (6th Cir. 1992), for instance, is fully consistent with this approach. That case held that section 544(b) incorporates a state avoidance statute that defines preferences differently from the federal definition in section 547(b). This is hardly surprising; there would be no point in expressly incorporating state laws if such laws did not occasionally differ from federal law. State laws incorporated by section 544(b) are part of the incentive system Congress set up in the Bankruptcy Code; they cannot be said to undermine these incentives. State laws that give assignees additional avoidance powers are not part of that system.

n8 We do not, as the dissent claims, question the

validity of voluntary assignments for the benefit of creditors, which have a venerable commonlaw pedigree, were upheld in Pobreslo and are specifically contemplated in the Bankruptcy Code. See, e.g., 11 U.S.C. §§ 101(11)(B), 543(d)(2). The Pobreslo Court specifically noted that the voluntary assignment process it upheld did not create any new rights that did not already belong to the debtor or creditors:

> The [state voluntary assignment] law merely governs the administration of trusts created by deeds like that in question, which do not differ substantially from those arising under common law assignments for the benefit of creditors. The substantive rights under such assignments depend upon contract; the legislation merely governs the execution of the trusts on which the property is conveyed. And as proceedings under any such assignment may be terminated upon petition of creditors filed within the time and in the manner prescribed by the federal Act . . . it is apparent that Congress intended that such voluntary assignments, unless so put aside, should be regarded as not inconsistent with the purposes of the federal Act.

Pobreslo, 287 U.S. at 526 (citation omitted). The statute we confront here goes further, giving the state assignee entirely new powers that are not derived from contract and trust law.

DISSENTBY: Dorothy W. Nelson

DISSENT: D.W. NELSON, Circuit Judge, dissenting:

I respectfully dissent because I disagree with the majority's preemption analysis. The majority states that California Civil Procedure Code § 1800 is preempted by federal bankruptcy law. However, the reasoning by which the majority reaches this result would preempt any number of state laws governing voluntary assignments for the benefits of creditors because those laws have the effect of altering the incentives of various affected parties to initiate bankruptcy proceedings. Under the majority's reasoning, any state statutory scheme, including those governing voluntary assignments for the benefit of creditors, that "give[s] state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench[es] too close upon the exercise of the federal bankruptcy power." Majority Op. at page 431. State voluntary assignments, by definition, give the assignee more power than may be exercised by an individual creditor.[1] Because I believe that voluntary assignments for the benefit of creditors and related state statutes are not preempted by federal bankruptcy law, I cannot join the majority opinion.

Voluntary assignments for the benefit of creditors have their origins in English common law, and exist as an alternative to formal bankruptcy proceedings. See Credit Managers Ass'n v. Nat'l Indep. Bus. Alliance, 162 Cal. App. 3d 1166, 1169-1170, 209 Cal. Rptr. 119 (2d. Dist. 1984). California's scheme requires that any assignment be for the benefit of all creditors, and does

not allow preferences for any creditor or class of creditors. Cal. Civ. Proc. Code § 493.010(b)-(c). Creditors must be given notice and an opportunity to submit claims to the assignee. Cal. Civ. Proc. Code § 1802. These types of assignments are recognized by and incorporated in the federal bankruptcy code. See, e.g., 11 U.S.C. § 101(11)(B) (defining "custodian" as, inter alia, "assignee under a general assignment for the benefit of the debtor's creditors"); § 543(d)(2) (excusing assignees appointed more than 120 days before the filing of a petition from turning debtor's property over to the trustee).

In Pobreslo v. Boyd Co., the Supreme Court upheld a state scheme allowing voluntary assignment for the benefit of creditors, stating, "It is apparent that Congress intended that such voluntary assignments . . . should be regarded as not inconsistent with the purposes of the federal Act." 287 U.S. 518, 526, 77 L. Ed. 469, 52 S. Ct. 262, 53 S. Ct. 262 (1933). When voluntary assignments contribute to bankruptcy's goal of equitable distribution, "quite in harmony with the purposes of the federal Act, the provisions of [state voluntary assignment laws] serve to protect creditors against each other and go to assure equality of distribution unaffected by any requirement or condition in respect of discharge." Id. Accordingly, the Supreme Court has held that state laws providing for discharge of debts are preempted by federal bankruptcy law, see, e.g., International Shoe Co. v. Pinkus, 278 U.S. 261, 266, 73 L. Ed. 318, 49 S. Ct. 108 (1929), but has never suggested that state laws that regulate the distribution of assets in a voluntary assignment might face the same fate.

Yet the majority holds that section 1800 is preempted because it alters the incentives of creditors to initiate involuntary bankruptcy proceedings, thereby interfering with bankruptcy's goal of equitable distribution of a debtor's assets. The majority's concerns about section 1800 are not distinguishable from concerns about voluntary assignment provisions generally. See, e.g., Majority Op. at pages 427-29 (describing how state law interferes with the unique collective form of proceeding established by bankruptcy law; discussing use of "hand-picked" trustee in state proceedings). As the majority recognizes, Majority Op. at page 431 n.8, it is well established that there is a commonlaw right to make an assignment of property for the benefit of creditors. It is thus illogical that state laws that provide a forum for the equitable distribution of that property should be preempted by federal bankruptcy law.

The majority argues that if a preferential transfer is recovered by the assignee under section 1800, the same sum could not be recovered if a federal bankruptcy proceeding were initiated later. Majority Op. at pages 428-29. But California's preference recovery provision is, by design, virtually identical to the bankruptcy code's preferential transfer statute. See 11 U.S.C. § 547(b), Cal. Code Civ. Proc. § 1800(b); see also Angeles Electric Co. v. Superior Court, 27 Cal. App. 4th 426, 430-431, 32 Cal. Rptr. 2d 660 (2d Dist. 1994) (discussing intentional conformance of section 1800 with federal bankruptcy law). If the same transfer can be avoided in both the state and federal systems, how does the state system interfere with bankruptcy's goal of equitable distribution? Both the state and federal statutes serve to ensure equality of distribution and to deter the race

to recover assets before insolvency. See, e.g., H.R. Rep. 95-595, 177-178, reprinted in 1978 U.S.C.C.A.N. 5963, 6138; see also Angeles Electric Co., 27 Cal. App. 4th at 430-431 (applying federal bankruptcy case law to interpret California statute). That California's voluntary assignment system has such a provision makes it more capable of effectuating the equality of distribution that is the aim of the bankruptcy law; it does not necessarily interfere with bankruptcy's goal of achieving equal distribution. The majority states that such state provisions are preempted because "they will affect the incentives of various parties as to whether they wish to avail themselves of federal bankruptcy law." Majority Op. at page 430. The purposes of federal bankruptcy law--as the majority sees it--are to provide discharge of debt and equal distribution of assets to creditors. Majority Op. at page 426. I fail to see how a preference recovery provision that assists in equal distribution interferes with either goal.

When the majority's reasoning is carried to its logical extension, it has the effect of pushing corporations threatened with insolvency from the less stigmatic, and less costly, voluntary assignment scheme into the world of federal bankruptcy. This should not have to be the case. I believe that both voluntary assignments and the bankruptcy system can "peaceably coexist" as twin mechanisms aimed at distributing the resources of an insolvent debtor. That voluntary assignments are incorporated into bankruptcy law, and that they have existed alongside bankruptcy law since its inception without causing an interference with the goal of equitable distribution, supports my conclusion that state voluntary assignments and the laws that effectuate them, should not be preempted by

bankruptcy law. "Federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons--either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142, 10 L. Ed. 2d 248, 83 S. Ct. 1210 (1963). Here, Congress has not indicated that voluntary assignments, generally, or preferential transfer avoidance statutes, specifically, are to be preempted. Nor is the nature of the regulated activity--distribution of a debtor's assets--such that it is impossible to conclude that the state and federal schemes could not co-exist. The majority privileges federal bankruptcy law by suggesting that these collective proceedings are the only ones that Congress intended for the equitable distribution of debt to creditors. Because I am convinced that the two systems should co-exist, I respectfully DISSENT.

---------- Footnotes ----------

n1 The majority asserts that it does not question the validity of assignments for the benefit of creditors and that it invalidates section 1800 because it gives the state assignee new powers that are not derived from trust or contract law. Majority Op. at page 431 n.8. The state assignee, regardless of the powers granted by section 1800, distributes a debtors assets among creditors and otherwise exercises powers on behalf of all creditors, thus exercising powers greater than any one creditor could exercise. I find it thus difficult to draw a line between the majority's arguments regarding section 1800 and problems with voluntary assignments, generally.

No. 01-5403 GAF (BQRx)
UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,
Plaintiff,

v.

LYCOS, INC., a Delaware Corporation aka Delaware Lycos, Inc.,
Defendant.

1/10/03

ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

I.
INTRODUCTION

In 1999, shortly before the telecommunications industry imploded, Defendant Lycos, Inc., an operator of internet web sites, entered into a $20 million contract to provide web-based services to International ThinkLink Corporation, a fledgling outfit whose business plan was to provide messaging and communications services to its customers. By October 2000, ThinkLink, rapidly on its way to insolvency, had failed to make its required payments under the contract and was given notice that it was in material breach of the agreement. In December 2000, ThinkLink and Lycos negotiated an amended agreement which required ThinkLink, among

other things, to make an immediate payment of $1 million to Lycos "for services rendered under the original Agreement." On February 14, 2001, 51 days after the $1 million was paid to Lycos, ThinkLink entered into a General Assignment for the benefit of creditors in favor of Plaintiff Sherwood Partners, Inc.

In the present suit, Sherwood, as the assignee for benefit of creditors, sues to set aside the $1 million payment as a preferential transfer. Lycos has counterclaimed asserting that, if the transfer is set aside, then the amended agreement, under which it accepted the $1 million in lieu of the $17 million due under the original agreement should be rescinded for failure of consideration. Sherwood now moves for summary judgment on its complaint to void the $1 million transfer, and on Lycos's counterclaim.

The historical facts are either undisputed or without substantial controversy and raise three legal issues that may be disposed of on summary judgment:

(1) was the $1 million dollar transfer, made within 60 days of the assignment for benefit of creditors given as payment for an antecedent debt and therefore voidable as a "preference" under controlling California law, or should it be characterized as a contemporaneous exchange for new value;
(2) did Lycos provide subsequent new value to the estate after the transfer to such an extent that it nearly equaled, equaled or exceeded the value of the transfer;
(3) if the Transfer was a voidable preference, is Lycos entitled to file a claim against the ThinkLink estate, notwithstanding that the formal deadline for fling claims has passed and, if so, can it seek recovery of the

entire $17 million dollars due under the original agreement?

On the basis of the uncontroverted facts, the Court concludes that the Transfer was a preference under California law and that Lycos's defenses fail as a matter of law. In addition, the Court finds that Lycos is entitled to file a claim against the ThinkLink estate, but only in the amount of the preference that it returns to Sherwood. Accordingly, the Court GRANTS Sherwood's motion for summary judgment.

II.
FACTUAL BACKGROUND

A. PARTIES

ThinkLink was a messaging and communications company that offered its subscribers integrated voicemail service, tax, pager notification, free local, 800-number and five cents-a-minute nationwide phone services. (Sherwood"s Statement of Undisputed Facts ("SUF") ¶ 1).

Lycos owns, operates and maintains a network of websites through which it makes available to Internet users a wide array of services and products. (Lycos' Corrected Statement of Genuine Issues ("SGI") ¶ 38).

B. ORIGINAL AGREEMENT AND THINKLINK's DEFAULT

ThinkLink and Lycos executed an E-Commerce Agreement ("Original Agreement") on December 21,1999. (SUF ¶ 1). Under this agreement, Lycos agreed to integrate links on its network that would

allow Lycos users to access cobranded webpages that (a) described ThinkLink's message and telephony services, and (b) allowed these users to subscribe and pay for such services. (SGI ¶ 44). In addition, under the Original Agreement ThinkLink had the exclusive right to provide certain defined message services on the Lycos network. (SGI ¶ 45). ThinkLink agreed to pay certain integration fees totaling $20,000,000 over the two years of the Agreement and to pay a portion of its net sales revenue. (Stritch Decl. at Exh. B § 7). In addition, Lycos and ThinkLink agreed to share any advertising revenue equally. (Id.).

On or about July 14, 2000, ThinkLink timely made the first payment due under the Original Agreement in the amount of $3,000,000. (SGI ¶ 3). However, no further payments were forthcoming. Hence, on October 20, 2400, Lycos sent ThinkLink a letter stating that ThinkLink is in material breach of the Agreement," and-that "[u]nder Section 16.1, Lycos has the right to immediately terminate the Agreement if ThinkLink fails to pay any amount due under the Agreement within five days after receiving written notice of such non-payment." (Stritch Decl., Exh. C).

C. THE AMENDED AGREEMENT

On or about December 23, 2000, ThinkLink and Lycos executed the Amended and Re-Stated E-Commerce Agreement ("Amended Agreement"). (SGI ¶ 5; Stritch Decl. at Exh. C). The Amended Agreement states "Prior to the Effective Date, ThinkLink paid Lycos three million dollars ($3,000,000) for a portion of the services under the original Agreement. On the Effective Date, ThinkLink shall pay Lycos an

additional one million dollars ($1,000,000) for services rendered under the original Agreement." (SUF ¶ 6). ThinkLink wire-transferred $1,000,000 to Lycos on December 26, 2000. (SUF ¶ 7; Stritch Decl. at ¶ 7). Lycos admits to receiving this $1.000,000. (SUF ¶ 11).

The termination provisions of the Amended Agreement provide that, if the Agreement were terminated, "ThinkLink shall be liable to Lycos for the payment of any and all amounts due and payable to Lycos prior to the effective date of such termination." (Stritch Decl. at Exh. C § 16.1) (emphasis added). On the date that the Amended Agreement was executed, ThinkLink owed Lycos $2.5 million in integration fees under the original Agreement. As of the date of ThinkLink's General Assignment for the Benefit of Creditors, ThinkLink would have owed Lycos $5 million under the original Agreement if it had not been amended. (Id. at §7).

D. THINKLINK'S GENERAL ASSIGNMENT FOR THE BENEFIT OF CREDITORS AND SUBSEQUENT SUIT

On February 14, 2001, ThinkLink executed a General Assignment of the Benefit of Creditors in favor of Sherwood, just 51 days after the $1,000,000 transfer to Lycos. (SUF/SGI ¶¶ 8,12,13,15). On March 23, 2001, Sherwood demanded from Lycos return of the $1 million, asserting that the Transfer was a voidable preference. (SUF ¶ 9). On May 18, 2001, Sherwood filed a Preference Complaint in Los Angeles Superior Court. (SUF ¶ 10). The suit was later removed to this Court. (Not. of Removal).

III.

DISCUSSION

A. STANDARD of REVIEW FOR SUMMARY JUDGMENT MOTIONS

Summary judgment is proper where "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." FED. R. Civ. P. 56(c). Thus, when addressing a motion for summary judgment, this Court must decide whether there exist "any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986).

The moving party has the burden of demonstrating the absence of a genuine issue of fact for trial. See id at 256. A party opposing a properly made and supported motion for summary judgment may not rest upon mere denials but "must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). In particular, when the non-moving party bears the burden of proving an element essential to its case, that party must make a showing sufficient to establish a genuine issue of material fact with respect to the existence of that element or be subject to summary judgment. See Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986).

An issue is genuine if evidence is produced that would allow a reasonable jury to reach a verdict in favor of the non-moving party. Anderson, 477 U.S. at 248. The Court must assume the truth of direct evidence set forth by the opposing party. See Hanon v.

Dataproducts Co., 976 F.2d 497, 507 (9th Cir.1992). However, where circumstantial evidence is presented, the Court may consider the plausibility and reasonableness of inferences arising therefrom. See Anderson, 477 U.S. at 249-50; TW Electrical Serv., Inc. v. Pac. Elec. Contractors Ass'n, 809 F.2d 626, 631-32 (9th Cir. 1987). In that regard, "a mere 'scintilla' of evidence will not be sufficient to defeat a properly supported motion for summary judgment; rather, the nonmoving party must introduce some 'significant probative evidence tending to support the claim.'" Summers v. Teichert & Sons Inc., 127 F.3d 1150, 1152 (9th Cir.1997) (quoting Anderson, 477 U.S. at 249, 252); Eisenberg v. Ins. Co. of North America, 815 F.2d 1285, 1288 (9th Cir.1987) (holding that summary judgment may be granted if "the evidence is merely colorable ... or is not significantly probative").

B. CALIFORNIA'S PREFERENCE STATUTE

California Civil Procedure Code Section 493.020 codified the common law right of a debtor to make a voluntary assignment for the benefit of his creditors.fn1 See Cal. C. Civ. Proc. § 493.020. Under California law, the assignee of any general assignment for the benefit of creditors may recover preferential transfers. See Id. § 1800. Preferences are transfers made: (1) by an insolvent debtor within 90 days of the debtor's assignment; (2) to or for the benefit of a creditor; (3) for or on account of an antecedent debt; and (4) that enables the creditor to get more than another creditor of the same class. See id § 1800(b). Once recovered, the preference is redistributed to the estate's creditors in accordance with the state law priority scheme. See id § 1801.

The purpose of permitting recovery of preferential transfers is to "discourag[e] creditors from racing to proceed against an insolvent debtor, and prevent [] one creditor from obtaining greater payment than others of its class." Blonder v. Cumberland Eng'g, 71 Cal. App. 4th 1057, 1064 (1999). Section 1800 was modeled after the federal bankruptcy preference provision, 11 U.S.C. § 347. See Angeles Electric Co. v. Super. Ct., 27 Cal. App. 4th 426, 431 (1994); see also Plaintiff's Request for Judicial Notice ("RJN") at Exh. 24(7), p. 223. The legislative history reveals that the underlying purpose of enacting Section 1800 was "to conform the California law to the extent possible with federal bankruptcy law in order to remove the incentive of the assignor or the creditors to prefer bankruptcy proceedings which would otherwise give them greater rights." See RJN at Exh. 24(6), p. 216;11 U.S.C. § 544(b).fn2

Subdivision (c) of Section 1800 sets out six exceptions to the assignee's authority to recover preferences. See CAL. Civ. Pro. Code § 1800(c); Angeles Elec. Co., 27 Cal. App. 4th at 430. Two exceptions are implicated in this case: the contemporaneous exchange for new value described in § 1800(c)(1) and the subsequent new value exception described in § 1800(c)(4). In § 1800(a)(5), the tern .new value" is defined to mean "money or money's worth in goods, services, or new credit, ... but does not include an obligation substituted for an existing obligation." Cal. C. Civ. Proc. § 1800(a)(5). Lycos bears the burden of proving its affirmative defenses) that the alleged preferential transfer falls within a statutory exception to Sherwood's avoidance power and of proving the specific amount of the Transfer that is protected by such affirmative defense(s). In re Bullion

Reserve of North America, 836 F.2d 1214 (9th Cir. 1988).

C. The Contemporaneous Exchange for New Value Exception

Sherwood contends that the Amended Agreement plainly establishes that the $1 million payment in December 2000, which was made by an insolvent debtor within 90 days of the assignment for benefit of creditors, was for or on account of an antecedent debt, and therefore may be set aside as a preference. Sherwood relies on the seemingly plain language of the Amended Agreement, which expressly states: "On the Effective Date, ThinkLink shall pay Lycos an additional one million dollars ($1,000,000) for services rendered under the original Agreement." (SGI ¶ 6) (emphasis added). Despite the wording of this contract term, Lycos contends that California law bars Sherwood from voiding the transfer because new value was given contemporaneously with the $1 million transfer. In substance Lycos argues that its release of ThinkLink's remaining payment obligation and its agreement to continue to provide services constitutes new value to the estate, which defeats the preference claim. Since the assertion that new value was given constitutes an affirmative defense to Sherwood's complaint, Lycos bears the burden of proof, and therefore must demonstrate that genuine issues of material fact exist on each of the elements of its affirmative defense.

The elements of the affirmative defense are set forth in California Code of Civil Procedure § 1800(c)(1), which states:

The assignee may not recover under this section a transfer: (1) To the extent that such transfer was: (A) Intended by the assignor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the assignor; and (B) In fact a substantially contemporaneous exchange.

Cal. C. Civ. Proc. § 1800(c)(1). Generally, forbearance in the collection of a debt is not deemed to constitute new value, as it does not actually "replenish" the assignor's estate. Angeles Elec. Co. v. Super. Ct., 27 Cal. App. 4th 426. 435 (1994); see also In re Cocolat, Inc., 176 B.R. 540, 548 (Bankr. N.D. Cal. 1995). As noted in In re Cocolat, "Courts have consistently rejected preference defendants' contentions that the 'release' of their unsecured claims to the extent of the payments received constituted 'new value.'" ld. at 548. Thus, the Court must consider whether a material issue of fact exists on the question of whether the payment constituted new value or the release of a pre-existing claim.

2. To Prove its Contemporaneous New Valve Exception, Lycos Must Invoke Extrinsic Evidence

Since the amended agreement in the present case would appear on its face to defeat the "contemporaneous exchange for new value defense," Lycos can defeat summary judgment only by establishing that extrinsic evidence should be considered in the interpretation of the agreement, and that, consideration of that evidence creates a genuine issue of material fact for trial. Whether extrinsic evidence should be considered must be determined

under Massachusetts law because of the contract's choice of law provision. (Stritch Decl., Exh. B § 20) ("This Agreement. ..shall be construed in accordance with, and all questions with respect thereto shall be determined by, the laws of the Commonwealth of Massachusetts.").

Under Massachusetts contract law "[c]ontracts that are free from ambiguity must be interpreted according to their plain terms." Suffolk Constr. Co. v. Lanco Scaffolding Co., 47 Mass. App. Ct. 725, 729 (1999).
The court must construe all words that are plain and free from ambiguity according to their usual and ordinary sense.... Contract language is ambiguous when an agreement's terms are inconsistent on their face or where the phraseology can support reasonable difference of opinion as to the meaning of the words employed and the obligations undertaken. However, an ambiguity is not created simply because a controversy exists between parties....

Id. (citations and quotation marks omitted); McCarthy v. McCarthy, 2902 WL 1067179, *2 (Mass. App. Div. May 20, 2002) ("It must be shown that reasonably intelligent persons would differ as to which one of two or more meanings is the proper one. The existence of a controversy between the parties does not itself create an ambiguity.) (citations omitted). Moreover, "[t]he parol evidence rule bars reliance on preliminary negotiations to undermine unambiguous language in a final, integrated agreement. Id. at *3. Thus, in McCarthy the court upheld a motion to dismiss plaintiffs breach of contract action where the trial court refused to consider extrinsic evidence because the contract was unambiguous and contained an integration

clause. Id.; see also Fleet Nat'l Bank v. H & D Entm't, Inc., 96 F.3d 532 (1st Cir. 1996) (extrinsic evidence may be used to interpret but not vary contract terms).

Massachusetts law varies little from California on this issue. Under California law, when a party seeks to admit parol evidence to interpret an agreement, the objective theory of contract requires a court to undertake a two step process to determine its admissibility. Winet v. Price, 4 Cal. App. 4th 1159, 1165 (1992). First, a court is to review all credible evidence concerning the parties' intentions to ascertain whether the contract is reasonably susceptible to multiple interpretations. Id. Only if this step convinces the court that the contract's terms are ambiguous may it proceed to the next step of formally admitting the evidence to aid in interpreting the contract. Id. Otherwise, the interpretation of the contract must be guided solely by the text of the agreement and principles of construction designed to give effect to the objectively manifested intent of the parties. Id. at 1166. "It is the outward expression of the agreement, rather than a party's unexpressed intention, which the court will enforce." Id.

In this case, the contract language could hardly be any more clear. The parties agreed, in the text of their contract, that the $1 million was paid for "services under the original agreement. Nothing submitted by the parties convinces the Court that the apparently clear contract language contains any hidden meaning. Moreover, evidence submitted by Lycos confirms that the $1 million payment was intended as a settlement "of the current contract." (Gotham Decl., Exh. A). Accordingly, under either Massachusetts or California law, Lycos is barred from submitting parol evidence to

contradict the Amended Agreement's clear terms. Thus, Lycos' has failed to raise a material issue of fact for trial regarding the proper characterization of the $1 million dollar payment. On the undisputed record, the Court concludes that the payment was made on account of an antecedent debt.

D. THE SUBSEOUENT NEW Value Exception UNDER CALIFORNIA LAW

The next issue is whether Lycos has established the existence of a genuine issue of material fact for trial on its subsequent new value defense. In argument, if not in its papers, Lycos argued that it continued to offer services to ThinkLink during the December to February period, and that those services constituted subsequent new value of at least $1 million. Lycos offered the declaration of Richard Gotham, its Vice-President of Sales from December 2000 to August 2002, as to the value of services rendered under the Amended Agreement. Sherwood claims that Lycos has conflated "new value" with "consideration" and has offered no admissible evidence regarding the value of services rendered.

1. Defendant Bears the Burden of Proving the Subsequent New Value Exception

Section 1800(c)(4) describes the subsequent new value exception, which Lycos also invokes and bears the burden of proving. See Schwinn Bicycle Co. v. Schwinn Plan Comm., 205 B.R. 557, 558 (Bankr. N.D. Ill. 1957). Under this exception the assignee may not recover a transfer:

To or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the assignor: (A) Not secured by an otherwise unavoidable security interest; and (B) On account of which new value the assignor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

Cal. C. Civ. Proc. § 1800(c)(4).

"The 'new value' defense is grounded in the principle that the transfer of new value to the debtor will offset the payments and the debtor's estate will not be depleted to the detriment of other creditors." Maxwell Newspapers, Inc. v. Travelers Indem. Co., 192 B.R. 633, 635 (Bankr. S.D.N.Y.1996). In light of this goal, the defendant to a preference action bears the burden of proving the affirmative defense of subsequent value, which includes proving the specific amount of subsequent new value. See Sender v. C & R Co., 149 B.R. 941 (D. Colo. 1992); In re Workboats Northwest. Inc., 201 B.R. 563 (Bankr. W.D. Wash. 1996) ("Section 547(c)(4) protects a transfer only to the extent of the new value given, and a party asserting the defense must prove the specific measure of value given.") (citation omitted).

2. Analysis of the Amended Agreement Suggests That Little if any Subsequent New Value was Given, and If so the Value was Limited

The Amended Agreement's clear language indicates that the stock and/or $100,000, which Lycos had a right to request in the alternative, is the only payment to which Lycos is entitled for services provided pursuant

to the Amended Agreement. Moreover, as the Amended Agreement was effectively aborted after 51 days due to ThinkLink's collapse, Lycos only provided a portion of the services set forth in the Amended Agreement. An analysis of the Amended Agreement's language suggests that ThinkLink's estate received little concrete value from services rendered pursuant to the Amended Agreement.

The Amended Agreement provides in subsection 6.2 of the Payments section that:

As partial payment of the consideration due to Lycos for services provided by Lycos hereunder, ThinkLink will issue to Lycos one hundred thousand (100,000) shares of ThinkLink's Series D preferred stock, subject to the terms to be mutually agreed to by the parties...to the extent that mutually agreeable terms are not reached within forty-five (45) days following the Effective Date, Lycos shall have the right, at its option (in lieu of any equity), to request from ThinkLink a cash payment equal to one hundred thousand dollars ($100,000.00), which cash payment ThinkLink shall provide within fifteen (15) days following Lycos' request. (Gotham Decl., Exh. D, § 6.2).

The Amended Agreement's Payments section also contains subsections entitled Revenue Share, in which advertising revenue is discussed. The Advertising section grants Lycos the exclusive right to sell advertising and retain the revenue thereon for all pages except the sites related to ThinkLink services (ThinkLink "Materials"). (Id., Exh. D, § 7). ThinkLink has the exclusive right to sell advertising on ThinkLink Materials; however, "to the extent that ThinkLink

elects not to sell such advertising, Lycos shall have the right to sell such advertising and ThinkLink shall reasonably cooperate with Lycos in connection therewith." (Id at § 7.1). Regardless of which party sells the advertising, the Net Advertising Revenue 9defined effectively as 80% of the gross advertising revenue)fn4 will be shared equally by the parties. (Id. at § 7.2). Lycos provided no evidence that any advertising revenue was disbursed to ThinkLink arising from this Amended Agreement.

The final subsection in the Payments section, entitled No Other Payments, states that "The payments set forth in this Section 6 and Section 7 are the only payments required to be made by ThinkLink and Lycos in connection with this Agreement or the original Agreement." (Id. at § 6.4) (emphasis added).

The Amended Agreement also provides that "[e]ach party shall be responsible for its own costs and expenses incurred in performing such integration work, provided however, that ThinkLink will be responsible for software costs, hardware costs, and network costs relating to the Co-Branded Site." (Id at § 1.1.2).

Finally, the Amended Agreement shortened the exclusivity period granted to ThinkLink. ThinkLink only received a ninety (90) day exclusivity period, during which Lycos agreed not to offer competing providers' Message Services. Moreover, Lycos reserved the right to enter into an agreement with a competing provider of Message Services during the Exclusivity Period "so long as Lycos does not provide such Messaging Services on the Lycos Network during the Exclusivity Period." (Id. at § 4). In sum, the value to

the ThinkLink estate from this limited exclusivity period is speculative.

Notwithstanding the Amended Agreement's language, Cal. Code. Civ. Proc. 1800(c)(4) suggests that Lycos is entitled to retain the value of the alleged transfer to the extent that Lycos provided subsequent new value to the ThinkLink estate and can sufficiently prove the value thereof. See CAL C. CIV. PROC. § 1800(c)(4). However, new value is not the same as consideration - Lycos must prove actual replenishment of the estate, not merely that Lycos gave value in return for the Amended Agreement. See Angeles Elec. Co., 27 Cal. App. 4th at 434 ("[N]ew value is not a synonym for consideration... new value is a more limited concept; it requires the infusion of value into the estate of the debtor-transferor."). Unfortunately, as described below, Lycos only provides inadmissible estimates of Lycos' opportunity costs rather than providing admissible evidence of new value provided to the ThinkLink estate.

3. Gotham's Estimates and Sherwood's Evidentiary Objections Thereto

Richard Gotham, Vice President of Sales at Lycos, alleges that Lycos provided subsequent value to ThinkLink in the amount of $698,630 for the Exclusivity Period and $174,657 for the promotions of ThinkLink's Message Services on Lycos' websites. (SGI ¶ 83; Gotham Decl. ¶ 25). Sherwood objects to Gotham"s assertions for lack of expertise, foundation, inadmissible hearsay, and irrelevance. (Sherwood Evidentiary Objections). These objections are well taken. First, Mr. Gotham, says be based his estimates on "data from

comparable transactions in 1999 and 2000" and "his knowledge of the market for internet services at the time." (Gotham Decl. ¶ 25). However, Mr. Gotharn does not identify the transactions to which he refers or provide the data on which he relies. Moreover, Lycos cannot credibly argue that the market for telecommunication or Internet services during 1999 and 2000 was comparable to the market for services during the relevant period, the first quarter of 2001. Moreover, even if the Court were to accept some of his testimony, Mr. Gotham's analysis focuses more on Lycos' opportunity costs rather than the value which accrued to the ThinkLink estate, which is the relevant inquiry under preference law.

In the end, the question is whether the estate, which was reduced by $1 million in December 2000, was replenished in a substantially equal sum during the following two months. No dispute exists on that question, the answer to which is "No." Hence, Lycos has not raised a genuine issue of material fact for trial on the question of whether it provided ThinkLink with subsequent "new value" that substantially offset the $1 million December 2000 transfer.

E. INTEREST

When the amount of a judgment is certain as of a particular date prior to judgment, the prevailing party is entitled to prejudgment interest as of the date when the amount was certain. See Cal. Civ. Code, § 3287(a); see also Credit Managers' Ass'n of S. Cal. v. Brubeker, 233 Cal. App. 3d 1587 (1991) (holding that, under Cal. Civ. Code § 3287(a)), plaintiff in preference action who sent demand letter to defendant was "entitled as a

matter of right to prejudgment interest [from the date of the demand letter] because the damages were certain or capable of being made certain by calculation."). Generally, courts have allowed prejudgment interest in preference actions either from the date of demand for return of the preference or the date on which an action to recover the preference is commenced. See In re Four Seasons Sporting Goods Inc., 46 B.R. 528, 530 (Bankr. N.D. Cal. 1985) ("It is well settled that in an action to set aside a preference the trustee is entitled to prejudgment interest from the date of demand for its return, or, in the absence of a prior demand, from the date of commencement of the adversary proceeding.").

In this case, Sherwood is entitled to prejudgment interest from March 29, 2001, when it served Lycos with a letter stating that Lycos had received a $1,000,000 preferential payment that had to be returned to Sherwood pursuant to Cal. C. Civ. Proc. § 1800. (Mot. at 10).

F. LYCOS' COUNTERCLAIM FOR DECLARATORY RELIEF

1. Lycos is Entitled to File a Claim Against the ThinkLink Estate

Although Cal. C. Civ. Proc. § 1800 contains no language so stating, the analogous language from the Federal Bankruptcy Code implies that Lycos is entitled to file a belated proof of claim if this Court decides the Transfer was a voidable preference and if Lycos returns to the ThinkLink estate the amount that the Court determines is a voidable preference. See Fed. R. Bankr.

P. 3002(c)(3). Indeed, as stated in this Court's prior Order Re: Defendant's Motion to Dismiss:

Although the Califomia preference statute does not explicitly mention that targets of preference lawsuits are entitled to share in the final distribution of the debtor's estate, it seems fairly obvious that this right exists, even absent a specific statutory provision. Bona fide creditors who are required to disgorge a preference will still be considered a creditor" for purposes of receiving an equal share of the debtor's estate.

February 14, 2002 Order at 15. Thus, it appears clear that Lycos is entitled to file a belated proof of claim against the ThinkLink estate of whatever amount this Court determines is a voidable preference -- so long as Lycos in fact returns that amount to Sherwood. Moreover, Sherwood concedes that "a claim in the amount of the sum paid to Plaintiff as a result of this litigation will be allowed as an unsecured claim in the ThinkLink assignment estate." (Corrected Reply at 15).

2. The Amended Agreement is Not an Accord, But Rather a Substituted Contract, Which is Not Extinguished by Lycos Returning the $1,000,000.

Lycos claims that the Amended Agreement is an accord to settle Lycos' claims against ThinkLink. As a result, Lycos argues that "[r]equiring Lycos to disgorge the entire consideration...constitutes...a failure of consideration entitling Lycos to assert the full amount of its claims under the original Agreement against ThinkLink's assignment estate." (Amended Corrected Opp. at 12).

In contrast, Sherwood argues that "[t]his Court has already ruled the instant litigation does not arise out of the Amended Agreement, but as a result of the assignment. Therefore, the doctrine of the law of the case precludes all of Lycos' arguments based on contract law." (Corrected Reply at 15). Moreover, Sherwood argues that analogous federal bankruptcy law allows Lycos to file a late claim only for the sum that it repays pursuant to a judgment in a preference action. (Id.) (referring to 11 U.S.C. § 502(h)).

Whether the Amended Agreement is an accord or a substituted contract is a question of interpretation. See In re Goldstein, 234 B.R. 214, 223 (Bankr. D. Mass. 1999).

If the original obligation is undisputed, liquidated and matured, the obligee is unlikely to accept a mere promise to satisfy the obligation, so more likely than not the agreement constitutes an accord. If the promise is to pay a lesser amount, however, a fact finder may conclude that the parties intended to enter into a new agreement, sometimes referred to as an accord and satisfaction, which extinguishes the prior obligation.

Id. (citations omitted).

The observation of the Goldstein is reflected in the terms of the amended and restated agreement. The integration clause expressly states that, "This agreement supersedes all previous agreements between Lycos and ThinkLink concerning the subject matter . . . ." (Stritch Decl. at Exh. D. § 27) Thus, taking the parties at their word, the Court concludes that the Amended Agreement constitutes a substituted

contract, which discharged the parties' duty under the Original Agreement and replaced it with a new duty under the Amended Agreement. Accordingly, Lycos may submit a claim, but can only recover under the Amended Agreement up to the amount of the preference returned to Sherwood.

IV.
CONCLUSION

For the reasons set forth above, the Court GRANTS Sherwood's Motion for Summary Judgment as to its Complaint and GRANTS in part and DENIES in part Lycos' counterclaim for injunctive relief. Lycos should be entitled to file a belated claim against the ThinkLink estate, but only for the amount of the Transfer that it returns to Sherwood pursuant to this Court's Order. Sherwood is to prepare a judgment that conforms to the terms of this memorandum.

IT IS SO ORDERED.

DATED: January 10, 2003

Footnotes

fn1 An assignment for the benefit of creditors is essentially a liquidation device whereby the assignee acts as a trustee and obtains title to the debtor's assets, liquidates them and distributes there equally among creditors without conditioning distributions on the creditors' agreement to release the debtor's unpaid liability. In re Newport Offshore Ltd., 219 B.R. 341, 352 n.23 (D.R.I. 1998). An assignment for the benefit of creditors is a less expensive altemative to bankruptcy.

(Plaintiffs Request for Judicial Notice ("RJN") at Exh. 24(4), p. 203).

fn2 Section 544(b) allows bankruptcy trustees to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim...." Id.

fn3 The agreement also contains the following integration clause:

This Agreement contains the entire understanding of the parties hereto with respect to the transactions and matters contemplated hereby, supercedes all previous agreements between Lycos and ThinkLink conceming the subject matter ... No party hereto has relied on any statement, representation, promise of any other party or with any other officer, agent, employee-or attorney-for the other party in executing this Agreement except as expressly stated herein. (Stritch Decl. at Exh. D).

fn4 ThinkLink's costs are deemed to be a flat 20 percent of gross advertising revenue. (Id. at § 7.1).

No. 01-5403 GAF (BQRx)
UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,
Plaintiff,

v.

LYCOS, INC., a Delaware Corporation aka Delaware Lycos, Inc.,
Defendant.

1/17/03

JUDGMENT

This cause was heard on the Motion of Plaintiff and Counterclaim Defendant Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation for Summary Judgment or, in the alternative, for Partial Summary Adjudication against Defendant and Counterclaimant Lycos, Inc. on December 16. 2002. The Court issued its Order Granting Plaintiffs Motion for Summary Judgment on January 10, 2003, which was entered on January 13, 2003. Based thereon, it is further

ORDERED, ADJUDGED AND DECREED that:

1. Plaintiff and Counterclaim Defendant Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation recover from Defendant Lycos, Inc. the principal sum of $1,000,000,

plus pre-judgment interest thereon at the rate of seven percent per annum from March 29, 2001 until January 16, 2003, in the sum of $***** costs pursuant to Costs Bill to be filed in accordance with Fed. R. Civ. P. 54 and thereafter, postjudgment interest pursuant to 28 U.S.C. § 1961 from date of entry of Judgment until paid; and

2. Defendant Lycos, Inc. shall be entitled to file a claim against the Assignment Estate of International ThinkLink Corporation for the amount it actually paid over to Plaintiff Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation pursuant to this Judgment, provided said claim is filed within thirty days (30) after this Judgment becomes final, and the filing of said claim shall be deemed timely.

No. 01-5403 GAF (BQRx)
UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,
Plaintiff,

v.

LYCOS, INC., aka Delaware Lycos, Inc., and DOES 1-20 inclusive
Defendant.

2/14/02

ORDER RE: DEFENDANT'S MOTION TO DISMISS

I.
INTRODUCTION

This is an action by Plaintiff Sherwood Partners, Inc. ("Sherwood") to recover a one million dollar payment made by International Thinklink Corporation ("Thinklink") to Defendant Lycos, Inc. ("Lycos"). Sherwood is the assignee for the benefit of Thinklink's creditors and contends that the payment in question was a "preferential transfer" prohibited by state law. Lycos removed the action to this Court and now moves to dismiss claiming that (1) venue in the Central District is improper and (2) the action is preempted by federal law.

With respect to venue, Lycos claims that this action should be subject to the forum selection clause contained in the underlying contract between it and Thinklink, which calls for all actions related to the contract to be litigated in Massachusetts. Lycos is incorrect for two reasons. First, as an assignee for the benefit of Thinklink's creditors, Sherwood is not a party to that contract. Second, Sherwood's state law claim to avoid the transfer exists independently of the contract and therefore is not a claim within the scope of the forum selection clause.

Lycos' preemption argument presents a closer question. California state law provides for avoidance of preferential transfers, a device that was originally created in connection with the enactment of federal bankruptcy law. On the other hand, California law does not purport to discharge the debts of one who utilizes its procedures, which the Supreme Court has identified as the hallmark of the bankruptcy act. A venerable state decision addressing this point, Downer v. Porter, 76 S.W. 135 (Ct. App. Ky.1903), persuades this Court that federal bankruptcy laws do not preempt the California statute. That case analogizes preference avoidance to fraudulent conveyance avoidance, and holds that a state may relieve against all frauds "actual or constructive." Id. at 135-36. Thus, although preference avoidance may have originally been created by bankruptcy law, state legislation that includes preference avoidance is not tantamount to bankruptcy" so long as it does not permit the discharge of debts. See Probeslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933). For these reasons, the Court DENIES the motion to dismiss.

II.
FACTUAL BACKGROUND

In December 1999, Thinklink and Lycos entered into an agreement under which Thinklink agreed to pay Lycos one million dollars by October 31, 2000 in exchange for various services.[1] (Complaint ("Comp.") ¶ 6). The parties subsequently amended the contract to provide for a payment deadline of December 23,.2000, however, no new consideration accompanied this change. (Id.) "Consequently, as of December 23, 2000, [Thinklink] owed Lycos an antecedent debt in the sum of $1,000,000." (Id.)

Sometime between December 23, 2000 and February 14, 2001, Thinklink paid Lycos the one million dollars. (Id. ¶ 8). On February 14, 2001, Thinklink made a general assignment for the benefit of its creditors to Sherwood.[2] (Id. ¶2). Sherwood then demanded Lycos to return the payment and when it refused Sherwood commenced this action in state court. (Id. ¶ 9). Sherwood contends that because the payment was made at a time when Thinklink was "insolvent," as that term is defined by state law, the payment may be avoided and recovered for the benefit of Thinklink's creditors. (Id. ¶¶12,14).

Lycos timely removed this action to federal court on June 19, 2001. It then filed the instant motion to dismiss pursuant to Federal Rules of Civil Procedure 12(b)(3) and (6) arguing that the action was improperly brought in California state court for two reasons. First, Lycos contends that this action is governed by the forum selection clause in the December 1999 contract between Thinklink and Lycos, which provides that "any action

related to [the contract] must be brought in a state or Federal court in the Commonwealth of Massachusetts." (Shea Dec. at ¶ 3). Second, Lycos argues that Sherwood's state law claim to avoid the transfer, which is based on California Code of Civil Procedure section 1800, is preempted by the federal Bankruptcy Code.

III.
ANALYSIS

A. LEGAL STANDARD FOR ENFORCEMENT of FORUM SELECTION CLAUSES

The Ninth Circuit has held that a motion to dismiss made pursuant to a forum selection clause should be treated as a motion to dismiss for improper venue under Federal Rule of Civil Procedure 12(b)(3). See Offshore Sportswear. Inc. v. Vuarnet Int B.V.,114 F.3d 848, 859 (9th Cir.1997); Argueta v. Banco Mexicano. S.A., 87 F.3d 320, 324 (9th Cir. 1996). In reviewing a motion to dismiss for improper venue, the Court need not accept the pleadings as true, and may consider facts outside of the pleadings. Id.

B. LEGAL STANDARD FOR MOTIONS TO DISMISS FOR FAILURE TO STATE A CLAIM

A Rule 12(b)(6) motion to dismiss tests the legal sufficiency of the claims asserted in the complaint. See FED. R. Civ. P. 12(b)(6). Dismissal is proper only where "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-48 (1957); Moore v. City of Costa Mesa, 886 F.2d 260, 282 (9th Cir.1989). In assessing the merits of a Rule

12(b)(6) motion, the Court must accept as true all material allegations in the complaint, as well as any reasonable inferences to be drawn from them. See NL Indus., Inc. v. Kaplan, 792 F.2d 898, 898 (9th Cir.1986).

C VENUE IS PROPER IN THE CENTRAL DISTRICT OF CALIFORNIA

Lycos first contends that this action should be dismissed because it was commenced in the wrong venue, namely, California state court.[3] Lycos argues that as an assignee, Sherwood stands in the shoes of Thinklink and therefore is bound by the forum selection clause in the December 23, 2000 agreement which lays venue for actions related to the contract in Massachusetts. (Mot. at 11-12).

Initially, it is worth noting that Lycos does not seriously press this argument, devoting only the final page of its motion to it and omitting it from its reply altogether. (Mot. at 12; Reply at 1 n.1). The problems with Lycos' argument are substantial. Sherwood was not a party to the contract and the cause of action it is suing under is one that was not created by the contract. Instead, Sherwood's. claim is created by state statute, Califomia Code of Civil Procedure § 1118, and is not one which could be maintained by Thinklink against Lycos. To the contrary, the cause of action is unique to Sherwood's status as an assignee for the benefit of Thinklink's creditors, which carries with it a number of rights and duties separate and apart from the rights it received from Thinklink.

Recent Ninth Circuit authority confirms that Sherwood should not be considered a party to the contract or a

party suing on the contract as a result of its assignment. See In re Connolly, 238 B.R. 475, 479 (Bankr. 9th Cir.1999). The appellant in Connolly successfully defended a preference action brought against him by the debtor's Unsecured Creditors' Committee. He then sought to recover his attorneys' fees from the Committee based on a provision in the underlying security agreement he had with the debtor. The bankruptcy court refused to award fees on this basis and the Ninth Circuit affirmed noting that, "[p]reference actions exist independently of underlying agreements because such actions arise out of the transfer of the debtor's interest in property, and such transfers can occur without an underlying contract." id. at 479.

Connolly establishes that Sherwood is not a party to the contract and its claim is not "related to the contract, as that term is used in the forum selection clause. Sherwood's statutory claim accrued independently of the contract and therefore Sherwood is not constrained by the forum selection clause.

D. CALIFORNIA'S PREFERENCE STATUTE IS NOT PREEMPTED BY FEDERAL LAW

California Code of Civil Procedure section 493.020 codified the common law right of a debtor to make a voluntary assignment for the benefit of his creditors.[4] Under California law, the assignee of a general assignment for the benefit of creditors may recover preferential transfers. Cal. Civ. Pro. Code § 1840. Preferences are transfers made within ninety-days of the assignment while the assignor is insolvent that favor one existing creditor over another. Section

1800(b). Once recovered, the preference is redistributed to the debtor's creditors in accordance with the state law priority scheme. The purpose of permitting recovery of preferential transfers is to "discourag[e] creditors from racing to proceed against an insolvent debtor, and, prevent.[] one creditor from obtaining greater payment than others of its class." Blonder v. Cumberland Eng'g, 71 Cal. App. 4th 1057,104 (1999). Section 1800 was modeled after the federal bankruptcy preference statute, Bankruptcy Code § 547. See Angeles Electric Co. v. Superior Court, 27 Cal. App. 4th 426, 431 (1994) (acknowledging that Section 1800 was patterned after the federal bankruptcy provision and construing the statute in accordance with the federal courts' construction of the federal bankruptcy provision); see also RJN at Ex. 24(1), p. 223. In fact, the legislative history reveals that the underlying purpose of enacting Section 1800 was "to conform the California law to the extent possible with federal bankruptcy law in order to remove the incentive of the assignor or the creditors to prefer bankruptcy proceedings which would otherwise give them greater rights." (RJN at Ex. 24(6), p. 216).

Lycos argues that Plaintiff cannot state a cause of action under California's preference statute because that provision is preempted by the United States Bankruptcy Code. According to Lycos, the California preference statute transforms Califomia's otherwise valid assignment for the benefit of creditors scheme into a law that impermissibly intrudes into a field exclusively occupied by the federal Bankruptcy Code. In addition, Lycos argues that the California preference statute is preempted because it directly conflicts with the federal preference statute.

1. General Preemption Principles

Under the Supremacy Clause, federal law may supersede state law when any one of six conditions exist:

[1] when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law, [2] when there is outright or actual conflict between federal and state law, [3] where compliance with both federal and state law is in effect physically impossible, [4] where there is implicit in federal law a barrier to state regulation, [5] where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law, or [8] where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress.

Louisiana Pub. Serv. Comm'n v. Federal Communications Comm'n, 476 U.S. 355, 368-69 1985](citations omitted). In short, state law may be preempted by an express congressional statement, by federal occupation of the field, or by direct conflict with federal law.

2. Preemption in the Bankruptcy Context

The United States Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies." U.S. Const. art. 1, § 8, cl. 4. Congress, however, did not exercise the bankruptcy power throughout most of the nineteenth century. Charles J. Tabb, The History of the Bankruptcy Laws in the United States, 3 Am. Bankr. Inst. L. Rev. 5, 48 (1995). During the periods when

Congress' bankruptcy powers remained dormant, many states enacted their own bankruptcy and insolvency laws. Id. Since the passage of the Bankruptcy Act of 1898; however, federal legislation has "occupied the field" of bankruptcy legislation, thereby suspending the operation of state bankruptcy laws. Id.; see also International Shoe Co. v. Pinku , 278 U.S. 261, 265 (1929)("The national purpose to establish uniformity necessarily excludes state regulation....States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations."). In addition to preempting state "bankruptcy" statutes, the Bankruptcy Code also preempts non-bankruptcy state laws that actually conflict with federal bankruptcy laws. See, e.g., Perez v. Campbell, 402 U.S. 637 (1971)(invalidating a state statute that suspended an individual's driver's license for nonpayment of a judgment arising from a motor vehicle accident, even though the judgment had been discharged in bankruptcy). Thus, the preemption issue can be summarized in the following manner:

In the bankruptcy context, there are two basic types of preemption issues. The first issue is the more global question of whether a state insolvency law is a "bankruptcy" law and thus generally preempted by Congress's exercise of its power under the Bankruptcy Clause. The second issue concerns whether a particular state statute conflicts with some specific aspect of the federal bankruptcy law.

Tabb, supra, at 47-48. Defendant Lycos argues that the California preference statute is invalid under both theories of preemption: field preemption and conflict preemption.

a. Field Preemption

Voluntary assignments for the benefit of creditors existed at common law, as they are rights inherent in the ownership of property. In re Tarnowski, 210 N.W. 888, 838 (Wis. 1926). For this reason, the Supreme Court has held that state statutes merely regulating voluntary assignments are not preempted by federal bankruptcy laws. Pobreslo v. Joseph M Boyd Co., 287 U.S. 518, 525 (1933). Although voluntary assignment schemes are generally valid, "it is possible that state legislation may go so far as to change the general assignment into a state insolvency system in conflict with or covering tht same subject matter as the Bankruptcy Act and where that occurs such legislation is held to be superseded by the paramount federal law." In re Wisconsin Builders Supply Co. 239 F.2d 649. 651 (7th Cir. 1957). However, "[t]here is no clear cut and definitive test by which to determine whether a state statute dealing with assignments for the benefit of creditors is so essentially a bankruptcy law as inherently to conflict with, and be suspended by, the federal Act. 5 Harold Remington, Remington on Bankruptcy § 2114 (James M. Henderson eds., 1953).

Lycos argues that California's preference statute impermissibly trespasses on a field of law exclusively occupied by the Bankruptcy Code. because it creates a competitive alternative to federal bankruptcy laws by importing a distinctive feature of bankruptcy law--preference recovery--on to California's otherwise valid common law assignment for the benefit of creditors scheme. (Mem. at 5; Reply at 7). Plaintiff, on the other hand, argues that preference law is not unique to bankruptcy law. (Opp. at 4). Specifically, Plaintiff claims

that "[p]reference avoidance is no more a distinctive feature of bankruptcy law than is fraudulent transfer avoidance, judicial lien avoidance, unperfected security interest avoidance, or other provisions which are designed to achieve equality of distribution among creditors of the same class." (Id. at 4, 5). Plaintiffs assertions, however, are false. Recovery of preferences is a unique creation of bankruptcy law. As one scholar explains:

Preference doctrine would seem to be a central part of bankruptcy law. If the general purpose of bankruptcy is to ensure a ratable distribution of the debtor's assets among the creditors, preference law would seem, by definition, to be a primary instrument for achieving that goal. Indeed, the preference, unlike its somewhat mismatched partner, the fraudulent conveyance, is strictly a creature of bankruptcy law, rather than a part of nonbankruptcy commercial law that simply receives special enforcement in the bankruptcy process.

Robert Weisberg, Commercial Morality the Merchant Character and the History of the Voidable Preference, 39 Stan. L. Rev. 3/3 (1986)(intemal citations omitted). See also, Thomas H. Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 25, 751(1984)(distinguishing preference law from fraudulent conveyance law, and providing a lengthy discussion on the interrelatedness of preference law and collective proceedings for collection and disbursement of assets).

Although preference law finds its origin exclusively in bankruptcy law, the question remains whether Califomia's preference statute is "tantamount to

bankruptcy" so that it is preempted by the Bankruptcy Code. See In re Newport Offshore Ltd., 219 B.R. 341, 351 (Bankr. D. R.I. 1998)("[w]hether a state law operates within the field of 'bankruptcy' so as to be suspended by a federal statute intended to effect uniform bankruptcy legislation is the essence of the preemption inquiry."). The Supreme Court provides some guidance in determining whether certain state statutes are preempted by federal bankruptcy law; namely, state laws governing general assignments for the benefit of creditors are clearly permitted, while state laws providing for a release or discharge by the creditors are clearly preempted.

As stated above, the Supreme Court has found that state laws regulating voluntary assignments for the benefit of creditors are not preempted by federal bankruptcy laws, even though they operate to distribute an insolvent's estate. Pobreslo, 287 U.S. at 526; Newport Offshore, 219 B.R. at 353. The Supreme Court has also concluded that state laws purporting to discharge the obligations of a debtor, or requiring creditors to stipulate to a discharge as a condition of participating in the distribution of the debtor's assets are preempted by federal bankruptcy laws. See Pinkus, 278 U.S. at 266. Perhap's one of the best explanations for this distinction is found in the often-quoted case of In re Tamowski, where the Wisconsin Supreme Court stated:

[T]here can be no doubt that legislation prescribing regulations for the administration of voluntary assignments constitutes one subject of legislation, while the discharge of bankrupts constitutes quite another. A voluntary assignment for the benefit of creditors is a

personal right inherent in the ownership of property. Such a right existed at common law independent of statute. The statutes do not confer the right, but statutes in this country have been enacted for the purpose of regulating the administration of the estate for the benefit of creditors. The discharge of the bankrupt from his debts constitutes the very essence of a bankrupt law. While the administration of the estate of the bankrupt and the distribution of the proceeds thereof pro rata among his creditors is a usual, if not a necessary, incident of a bankrupt law, the discharge of the debtor from his debts is no part of an assignment law. The winding up and a fair and equal distribution of the estate of insolvent debtors may arise in various ways, but where such a proceeding does not result in the discharge of the insolvent debtor statutes regulating such a proceeding do not conflict in any manner with the bankruptcy law, and it has been squarely held by the Supreme Court of the United States that such laws are not superseded by the national Bankruptcy Act.

Tarnowski 210 N.W. at 838(quoted in Pobreslo, 287 U.S. at 524). However, the line between permissible state statutes and those that impede upon the province of the Bankruptcy code is not clearly drawn because the presence or absence of a discharge provision is not the sole criterion for resolving the preemption issue. Wisconsin Builders Supply, 239 F.2d 649, 652 (7th Cir.1957); First National Bank of Albuquerque v Robinson, 107 F.2d 50, 53 (10th Cir.1939); In re Mader's Store for Men Inc., 254 N.W.2d 171, 180 (Wis. 1977); cf. In re Schwartz Bros. Inc., 58 F. Supp. 761, 766 (D. Minn. 1945)(finding the absence of a discharge provision highly significant where the statute also does not

contain a provision that seeks to rehabilitate or reorganize a corporation). Thus,"[p]hases of an assignment law other than discharge provisions may also categorize it as fundamentally an insolvency or bankruptcy law." Remington, supra, § 2114.

This case presents a difficult question because state law preference statutes do not fall squarely within the clearly defined parameters of the Bankruptcy Code's preemptive effect-they do not stand on the same footing as general assignments for the benefit of creditors because preference recovery did not exist at common law, but at the same time, they fall short of discharging the debtor's obligations. While Defendant asserts that neither the Supreme Court nor the Ninth circuit has addressed the issue of whether state preference recovery statutes are preempted by federal bankruptcy law, Plaintiff claims that such statutes have been "uniformly upheld againsl preemption attack." (Reply at 7; Opp. at 13). Although Plaintiff cites a number of cases in support of its argument, the only case that actually addresses the preemption issue that is presently before this Court is Downer v. Porter, 75 S.W. 135 (Ct. App. Ky. 1903).[5]

In Downer, the debtor conveyed a house to Downer in consideration of a preexisting debt. Id. at 135. Shortly thereafter, the debtor made a general assignment for the benefit of his creditors and the assignee filed suit to recover the property under a Kentucky statute permitting recovery of preferential and fraudulent transfers. Id. The lower court allowed the assignee to recover the property pursuant to the state statute, and Downer appealed. Id. Downer argued that the assignee could not maintain an action under the Kentucky

statute because a federal bankruptcylaw was in effect when the transaction occurred, which made the debtors general assignment and preferential transfer acts of bankruptcy. Id. The Court of Appeals, affirming the lower courts decision, concluded that the preference statute was not a "bankruptcy law and therefore creditors were not prevented from seeking relief in state court absent federal bankruptcy proceedings. Id. at 135-36. The court explained:

Any fraudulent conveyance of property is an act of bankruptcy under the federal statute, no less than the making of a deed of assignment for the benefit of creditors, or the preferring of one creditor to others. And if the act of Congress making these things acts of bankruptcy supersedes the state laws giving remedies therefor, then it would follow that since the passage of the bankruptcy act a creditor cannot take out an execution in the state court's on a judgment, and subject property thus fraudulently conveyed, or subject if in an attachment proceeding or upon a return of no property, although no petition in bankruptcy had been filed in the federal court impeaching the transactions as acts of bankruptcy. This was not the meaning of the act of Congress, and, the matters complained of having never been impeached as acts of bankruptcy, the state courts have jurisdiction to take charge of the property and distribute the proceeds ratably among all the creditors. It is fairly settled by the authorities that the state courts may do this in the case of a voluntary assignment for the benefit of creditors which has not been attacked as an act of bankruptcy. The statute quoted above vests in the assignee not only the property conveyed to him by the assignor, but also all the property conveyed away by the assignor by a

preferential or fraudulent transfer ....If the state courts may enforce voluntary assignments for the benefit of creditors, they may certainly enforce a statute like this, merely regulating what property shall vest in the assignee under the deed of assignment.

Id. at 136.

The Kentucky Court of Appeals' view of preference statutes as a natural and valid extension of voluntary assignments for the benefit of creditors is persuasive. By allowing states to regulate voluntary assignments for the benefit of creditors, Congress authorizes states to distribute the property of an insolvent equally amongst his creditors. Preference recovery statutes, unlike discharge provisions, are necessary to ensure that all creditors are treated equally--which is the very purpose of voluntary assignments. Thus, preference statutes should not be preempted by federal bankruptcy laws. This conclusion is further supported by the fact that federal bankruptcy trustees are authorized to use state preference statutes to void, transfers that could not otherwise be recovered under the federal statute. See Bank. Code § 544(b).[6]

b. Conflict Preemption

Lycos also asserts that the California preference statute, although modeled after the Bankruptcy Code's preference scheme, is preempted by the Bankruptcy Code because it directly conflicts with that statute. Defendant claims that Section 1800 omits fundamental procedural protections and substantive rights that the federal statute affords to targets of preference lawsuits. Specifically, Defendant argues that Section 1800 does

not provide a mechanism to allow creditors who are required to disgorge preferential payments to recover against the assignment estate. (Mem. at 7 n.7). According to Defendant, Section 1800 also lacks certain procedural protections calculated to prevent self-dealing, such as requiring the trustee in bankruptcy to be "disinterested." (Reply at 23).

The Court concludes that these differences do not require it to rule that the Califomia statute directly conflicts with the Bankruptcy Code. Both statutes seek to accomplish the same goals ensuring equality of distribution among creditors. Although the Califomia preference statute does not explicitly mention that targets of preference lawsuits will be entitled to share in the final distribution of the debtor's estate, it seems fairly obvious that this right exists even absent a specific statutory provision. A bona fide creditor who is required to disgorge a preference will still be considered a creditor' for purposes of receiving an equal share of the debtor's estate. Furthermore, under general principles of trust law, an assignee owes all creditors a fiduciary duty to refrain from self-dealing. Thus, the absence of a specific provision requiring the assignee to be "disinterested" is not essential to ensure that targets of preferential lawsuits are treated fairly.

IV.
CONCLUSION

For the reasons set forth above, Defendant's Motion to Dismiss Pursuant to Federal Rules of Civil Procedure 12(b)(3) and 12(b)(6) is DENIED.

IT IS SO ORDERED.

DATED: February 14, 2002

Footnotes

[1]For purposes of deeding this motion, the Court accepts all of Plaintiff's well-pleaded factual allegations as true. Cahill v. L berfy Mut. Ins. Co., 80 F.3d 336, 338 (9th Cir.1996).

[2]Although Sherwood claims Thinklink was insolvent, Thinklink has never declared bankruptcy either voluntarily or involuntarily. (Opp. at 2).

[3]Lycos has not waived its venue objection by removing this action from state court. La mbert v. Kysar, 983 F.2 1110, 1113 n. 2 (1st Cir. 1993)("The filing of a removal petition in a diversity action, without more, does not waive the right to object in federal court to the state court venue.").

[4]An assignment for the benefit of creditors is essentially a liquidation device whereby the assignee acts as a trustee and obtains title to the debtor's assets, liquidates them and distributes them equally among creditors without conditioning distributions on the creditors' agreement to release the debtor's unpaid liability. In re Newport Offshore Ltd., 219 B.R. 341, 352 n.23 (D. R.I. 1998). An assignment for the benefit of creditors is a less expensive alternative to bankruptcy. (Plaintiffs Request for Judicial Notice ("RJN") at Ex. 24(4), p. 203).

[5]Plaintiff relies on other cases that fall within one of two categories; (1) federal cases where the courts uphold state laws regulating general assignments for the

benefit of creditors, without ever mentioning the preference provisions contained in them; or (2) state court cases where the courts enforce preference provisions without ever mentioning the preemption issue. The Court will not base its decision on these cases or speculate as to their implied holdings.

[6]Section 544(b) allows bankruptcy trustees to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim...." (emphasis added). Defendant argues that the Bankruptcy Code disbnguishes "creditors" from "creditor representatives," and therefore section 544(b) would not allow a bankruptcy trustee to utilize Califomia's preference statute because only assignees, not individual creditors, can recover preferences under California law. At least one court, however, has allowed a bankruptcy trustee to assert an assignee's voiding power through section 544(b), even though-the assignee was not a creditor of the debtor. See In re Kenval Mktg. Corp., 69 B.R. 922 (E.D. Pa. 1987).

No. 03-55247

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,
Plaintiff-counter-defendant-Appellee,

v.

LYCOS, INC., a Delaware Corporation aka Delaware Lycos, Inc.,
Defendant-counter-claimant-Appellant.

3/1/05

ORDER

Before: D.W. NELSON, KOZINSKI and GRABER, Circuit Judges. The petition for panel rehearing and suggestion for rehearing en banc is DENIED. See Fed. R. App. P. 35; Fed. R. App. P. 40. Judge Nelson would grant the petition.

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(2)

No. 04-1607

IN THE

Supreme Court of the United States

SHERWOOD PARTNERS, INC., ASSIGNEE FOR THE BENEFIT OF CREDITORS OF INTERNATIONAL THINKLINK CORPORATION,

Petitioner,

v.

LYCOS, INC., A DELAWARE CORPORATION A/K/A DELAWARE LYCOS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the federal Bankruptcy Code preempts a California statute that vests an assignee selected by a debtor with the power to set aside and recover otherwise lawful transfers to creditors that cannot be recovered by either the debtor/assignor, individual creditors or a trustee in bankruptcy.

CORPORATE DISCLOSURE STATEMENT

Respondent, Lycos, Inc. ("Lycos"), is wholly owned by Daum Communications Corp., a Korean company traded on KOSDAQ.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
CORPORATE DISCLOSURE STATEMENT	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	1
STATEMENT OF JURISDICTION	1
RELEVANT PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	3
A. Common Law Background	3
B. Underlying Facts	4
C. Litigation in the District Court	6
D. The Court of Appeals' Decision	7
REASONS FOR DENYING THE PETITION	10
I. THE COURT OF APPEALS' DECISION IS NOT A MATTER OF NATIONAL IMPORTANCE AS THE DECISION WILL HAVE MINIMAL IMPACT ON THE ADMINISTRATION OF BANKRUPTCY ESTATES AND OUT-OF-COURT LIQUIDATIONS ADMINISTERED UNDER STATE LAW.	10

Contents

Page

A. The Court of Appeals' decision does not call into question the validity of assignments for the benefit of creditors and, on its face, has no application to individual creditor remedies or State laws governing the liquidation of corporate debtors. 10

B. Extra-judicial state law liquidations are not inherently less expensive or more equitable than liquidations effected through bankruptcy. 12

C. The substantial majority of States have no preference laws whatsoever. 14

D. The Petitioner also misstates the impact of the Ninth Circuit's decision on those states in which the Petitioner alleges that preference statutes continue to be "on the books." 15

II. THE DECISION BELOW DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT AND THERE IS NO SPLIT OF AUTHORITY ON THE NARROW ISSUE DECIDED BY THE NINTH CIRCUIT. 19

Contents

Page

A. No other Circuit has even considered the narrow issue raised in this case, much less resolved that question inconsistently with the decision below. 19

B. The validity of so-called "state anti-preference statutes" was not raised, discussed or decided in either *Pobreslo* or *Star*. 20

C. The Petitioner's reliance on *Stellwagen* is misplaced. 21

CONCLUSION 26

TABLE OF AUTHORITIES

Page

CASES

Brashear v. West, 32 U.S. 608 (1833) 3

Carruthers v. Kennedy, 166 N.E. 801 (Ohio 1929) ... 24

Clarke v. White, 37 U.S. 178 (1938) 4

Grupo Mexicana de Desarrallo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999) 4

Hartford Underwriters Ins. Co. v. Union Planters, N.A., 530 U.S. 1 (2000) 7

Johnson v. Star, 287 U.S. 527 (1933) 20, 21

Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933) 3, 20, 21

In re Roberds, Inc., 313 B.R. 732 (Bankr. S.D. Ohio 2004) 17

Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation v. Lycos, Inc., 394 F.3d 1198 (9th Cir. 2005). . .*passim*

Smith v. Cox, 831 P.2d 981 (N.M. 1992) 17-18

Stellwagen v. Clum, 245 U.S. 605 (1918) .. 21, 22, 23, 25

Cited Authorities

Page

Van Iderstine v. National Discount Co., 227 U.S. 575 (1913) 25

Webster v. Fall, 266 U.S. 507 (1925) 20

FEDERAL STATUTES

11 U.S.C. § 101, *et seq.* 6

11 U.S.C. § 326 ..... 12, 13

11 U.S.C. § 328 12

11 U.S.C. § 330 ..... 12, 14

11 U.S.C. § 544(b) 7, 8, 18, 21, 22

11 U.S.C. § 547 ..... 17, 24

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1441 6

Page

STATE STATUTES

Ariz. Rev. Stat. § 44-1041 16

Cal. Civ. Code § 22.2 11

Cal. Civ. Code § 1954.1 11

Cal. Civ. Code § 3439.07(d) 11

Cal. Civ. Proc. Code § 493.010 11

Cal. Civ. Proc. Code § 1204 11

Cal. Civ. Proc. Code § 1204.5 11

Cal. Civ. Proc. Code § 1800 ..... *passim*

Cal. Civ. Proc. Code § 1802 11

Ky. Rev. Stat. Ann. § 379.060 16

N.M. Stat. Ann. § 56-9-2 16

Ohio Rev. Code Ann. § 1313.58 16

Tex. Bus. Com. Code § 23.09 16

Uniform Commercial Code § 9-102(52) 16

Page

OTHER AUTHORITIES

6 AM. JUR. 2d, *Assignments for the Benefit of Creditors* §§ 1, 66 (2004) 3

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Page

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OPINIONS BELOW

The decision of the Court of Appeals for the Ninth Circuit (the "Court of Appeals" or the "Ninth Circuit") is reported at *Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005). (Appendix to Petition for Writ of Certiorari ("Pet. App.") 1a to 21a). The majority opinion was authored by Judge Alex Kozinski. The order of the Court of Appeals denying Petitioner's petition for rehearing and suggestion for rehearing *en banc* is not otherwise published. (Pet. App. 66a). No member of the Court of Appeals called for a response to the Petitioner's petition for rehearing and suggestion for rehearing *en banc*. The opinion of the District Court of the Central District of California that was reversed by the Court of Appeals is unreported. (Pet. App. 22a to 46a).

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on January 12, 2005. (Pet. App. 1a). Sherwood filed a timely petition for rehearing and suggestion for rehearing *en banc*. The Court of Appeals denied the petition for rehearing and suggestion for rehearing *en banc* pursuant to an order entered on March 1, 2005. (Pet. App. 66a). The certiorari jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS INVOLVED

The Court of Appeals held that the United States Bankruptcy Code preempts California Code of Civil Procedure Section 1800. Cal. Civ. Proc. Code § 1800, in pertinent part, provides that:

> The assignee of any general assignment for the benefit of creditors . . . may recover any transfer of property of the assignor:
>
> (1) To or for the benefit of a creditor;
>
> (2) For or on account of an antecedent debt owed by the assignor before the transfer was made;
>
> (3) Made while the assignor was insolvent;
>
> (4) Made on or within 90 days before the date of the making of the assignment . . .; and
>
> (5) That enables the creditor to receive more than another creditor of the same class.

See Cal. Civ. Proc. Code § 1800(b).

STATEMENT OF THE CASE

A. Common Law Background

This case concerns a state statute that vests assignees for benefit of creditors with the power to set aside and recover otherwise lawful pre-assignment transfers that "prefer" certain of the assignor's creditors. Assignments for the benefit of creditors are venerable common law devices for liquidating corporate debtors. In such common law assignments, the debtor voluntarily transfers its assets to an assignee who is charged with the duty to liquidate the assets and distribute the proceeds to creditors. *See, generally*, Charles Jordan Tabb, *The Law of Bankruptcy* § 1.5 (1997); 1 *Chapter 11 Theory and Practice: A Guide to Reorganization, Nonbankruptcy Options: Assignments, Compositions and Receiverships* § 2:04 (James F. Queenan et al. eds., 1994). At common law a debtor's ability to make an assignment for the benefit of creditors was viewed as a "necessary incident" to the ownership of property that included the power to dispose of property "as one may see fit." 6 AM. JUR. 2d, *Assignments for the Benefit of Creditors* §§ 1, 66 (2004); *see also Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 524, 526 (1933) (recognizing "the right to make a voluntary assignment for the benefit of creditors is a personal right inherent in the ownership of property, and existed at common law independent of statute" and that the "substantive rights" of the parties to the common law assignment derive from contract and trust law) (internal quotations omitted); *Brashear v. West*, 32 U.S. 608, 614 (1833) (stating that general assignments were recognized at common law without the necessity of any statutory authorization, as "[t]he right to make it results from the absolute ownership which every man claims over that which is his own"). Finally, at common law, the assignee stood in the place of the assignor and its rights were limited to those that the assignor could convey.

The power to avoid "preferences," in contrast, is grounded in statutory rather than common law. "A preference is a transfer that enables a creditor to receive payment of a greater percentage of his claim . . . than he would have received if the transfer had not been made and he had participated in the distribution of assets of the bankruptcy estate." H.R. Rep. No. 95-595, at 177 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138; s*ee also* Thomas H. Jackson, *The Logic And Limits Of Bankruptcy Law* 124-125 (Beard Books 2001) (1986); Douglas G. Baird, *Elements Of Bankruptcy* 147 (3d ed. 2001) (defining preferences as "eve-of-bankruptcy transfers to creditors that distort bankruptcy's *pro rata* sharing rule"). At common law, a debtor had every right to pay one creditor in preference to another and disfavored creditors (and the debtor itself) simply had no claim against the favored creditor, provided the transfer was made to satisfy a genuine obligation owed by the debtor. *See, e.g., Grupo Mexicana de Desarrallo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 322 (1999) (ruling that a federal district court lacked authority to issue a prejudgment injunction restraining a transfer of a debtor's property to a bona fide creditor because such a remedy was neither specifically authorized by statute nor an equitable remedy administered by courts of equity at the time of the enactment of the Judiciary Act of 1789); *Clarke v. White*, 37 U.S. 178, 200 (1938) (at common law an insolvent debtor could prefer certain creditors over others).

B. Underlying Facts

International Thinklink Corporation ("Thinklink") was a messaging and communications company that offered its subscribers unified telephone and message services. (Pet. App. 24a). Lycos owns, operates and maintains a

network of computer websites grouped under its brand (the "Lycos Network"), from which it makes available a wide array of services and products to internet users. (Pet. App. 24a).

On December 21, 1999, Thinklink and Lycos entered into an E-Commerce Agreement (the "Original Agreement") pursuant to which the parties agreed: (i) to create a co-branded version of Thinklink's website (the "Thinklink Site") on the Lycos Network, and (ii) that Thinklink would have the exclusive right to provide certain defined message services on the Lycos Network for two years. (Pet. App. 24a to 25a). Among other things, under the Original Agreement, visitors to the Lycos Network could access the Thinklink Site and subscribe to Thinklink's services. (Pet. App. 25a). For its exclusive access to the Lycos Network, Thinklink agreed to pay integration fees totaling $20,000,000 over the two year term of the Original Agreement, to pay a portion of its net sales revenue, and to share any advertising revenue. (Pet. App. 25a).

Following Thinklink's payment defaults, Lycos and Thinklink renegotiated their agreement and, on or about December 23, 2000, Thinklink and Lycos executed an Amended and Restated Commerce Agreement ("Amended Agreement"). (Pet. App. 25a to 26a). Under the Amended Agreement, Thinklink's exclusivity period was shortened from two years to 90 days, and Thinklink's outstanding payment obligations were reduced from more than $17 million to $1 million plus preferred stock. On December 26, 2000, Thinklink made the $1,000,000 payment contemplated by the Amended Agreement (the "Challenged Transfer") but failed to deliver the stock. (Pet. App. 2a).

On February 14, 2001, Thinklink made a general assignment for the benefit of its creditors to Sherwood Partners, Inc., (the "Petitioner"), as assignee, who almost immediately shut down Thinklink's operations and began liquidating Thinklink's business. (Pet. App. 2a).

C. Litigation in the District Court

On May 18, 2001, the Petitioner commenced a lawsuit against Lycos to recover the Challenged Transfer pursuant to the provisions of Cal. Civ. Proc. Code § 1800 in the Superior Court of the State of California for the County of Los Angeles. (Pet. App. 26a). In its Complaint, the Petitioner did not allege that the Challenged Transfer did not satisfy a bona fide debt that Thinklink owed to Lycos, nor did Petitioner allege that the Challenged Transfer was made to hinder, delay or defraud creditors. Rather, the gravamen of the Petitioner's claim under Cal. Civ. Proc. Code § 1800 was merely that the Challenged Transfer enabled Lycos "to receive more than another creditor of the same class." (Pet. App. 26a).

Lycos removed the action to the United States District Court for the Central District of California (the "District Court") on the basis of diversity jurisdiction pursuant to 28 U.S.C. § 1441. (Pet. App. 2a, 47a). On July 23, 2001, Lycos moved to dismiss the Complaint on the ground that Cal. Civ. Proc. Code § 1800 was preempted by the enactment of the Bankruptcy Code, 11 U.S.C. § 101, *et seq*. On February 14, 2002, the District Court denied Lycos's motion to dismiss. (Pet. App. 48a, 63a). On January 17, 2003, the District Court entered judgment against Lycos. Lycos timely appealed.

D. The Court of Appeals' Decision

The Court of Appeals reversed the District Court's judgment and held that Cal. Civ. Proc. Code § 1800 is preempted by the federal Bankruptcy Code. *Sherwood*, 394 F.3d at 1206. (Pet. App. 13a). The Court began its analysis of the preemption issue with a recognition that while "there can be no doubt that federal bankruptcy law is pervasive and involves a federal interest so dominant as to preclude enforcement of state laws on the same subject . . . federal law [also] coexists peaceably with, and often expressly incorporates, state laws regulating the rights and obligations of debtors (or their assignees), and creditors" (internal quotation marks omitted). *Id.* at 1201. (Pet. App. 4a). The Court of Appeals, however, rejected Sherwood's claim that the preference avoidance provisions of § 1800 are not only tolerated by but in fact are incorporated into the Bankruptcy Code through § 544(b). *Id.* at 1201-06. (Pet. App. 5a to 13a).

The Court of Appeals drew a distinction between state law remedies available to any individual creditor and "special avoidance powers" vested exclusively in statutory representatives of creditors. Under the express language of § 544(b) of the Bankruptcy Code, a trustee in bankruptcy succeeds only to the causes of action available to a "creditor holding an unsecured claim" to set aside a debtor's transfers under "applicable [state] law." *Id.* at 1201-02 & n.2. (Pet. App. 5a to 7a). Relying on this Court's recent decision in *Hartford Underwriters Ins. Co. v. Union Planters, N.A.*, 530 U.S. 1 (2000), the Court of Appeals explained that reading the word "creditor" in § 544(b) so as to include "assignees" under § 1800 was flatly contrary to the express language of the Bankruptcy Code. *Sherwood*, 394 F.3d at 1202 & n.4. (Pet. App. 6a to 7a, 14a). The Court further

emphasized that the Bankruptcy Code expressly distinguishes between "creditors," defined, in relevant part, as "entit[ies] that ha[ve] a claim against the debtor," and the broader class of "custodians" that encompasses statutory representatives of creditors such as receivers, trustees and "assignee[s] under a general assignment for the benefit of creditors." *Id.* at 1202. (Pet. App. 6a to 7a). The Court of Appeals concluded that because "Congress did not mention custodians alongside creditors in section 544(b)," trustees in bankruptcy do not succeed to the rights of custodians under state law. *Id.* (Pet. App. 6a). State statutes such as § 1800 that vest statutory representatives of creditors, to the exclusion of individual unsecured creditors, with the power to set aside and recover transfers not otherwise subject to avoidance at common law, accordingly, are not incorporated into federal bankruptcy law by the provisions of § 544(b). *Id.* (Pet. App. 6a to 7a).

The Court of Appeals then addressed whether a statute that vests custodians with "new avoidance powers" unavailable to individual creditors, if not incorporated into the Bankruptcy Code, was "inconsistent with the enactment and operation of the federal bankruptcy system." *Id.* at 1202-06. (Pet. App. 6a to 13a). The Court of Appeals concluded that "statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power." *Id.* at 1205-06. (Pet. App. 12a to 13a).

The Court's holding is premised on its recognition that, in a bankruptcy case, a trustee's exercise of the extraordinary power to avoid preferential transfers is subject to a host of procedural and substantive protections. *Id.* at 1204 & n.6. (Pet. App. 9a to 12a, 15a). Specifically, the Court of Appeals emphasized that this power may only be exercised under the

supervision of the federal courts; and the trustee exercising that power in a bankruptcy is not hand-picked by the debtor, but instead appointed and supervised by the United States Trustee (an official of the Department of Justice), or elected by the debtor's creditors. *Id.* at 1204. (Pet. App. 10a). The Court also stressed that federal bankruptcy law protects creditors from the trustee's possible conflicts of interest and possible self-dealing through a panoply of substantive and procedural provisions regulating, among other things, the trustee's employment of (and payment to) professionals to litigate such claims. *Id.* (Pet. App. 10a).

The Court of Appeals further reasoned that the commencement of state proceedings to recover transfers unassailable by individual creditors necessarily altered the incentives of creditors to seek federal bankruptcy relief and, as a practical matter, made it much more difficult for creditors, particularly out-of-state creditors, to avail themselves of the protections afforded by federal law. *Id.* at 1205. (Pet. App. 11a to 12a). Ultimately, the Court of Appeals determined that "Congress has thought carefully about how collective insolvency proceedings are to be conducted and set both substantive standards and elaborate procedural protections to ensure a result that is fair to debtors and creditors alike." *Id.* at 1205-06. (Pet. App. 13a). Accordingly, the Court of Appeals concluded that a California statute that vests unsupervised assignees, hand-picked by the debtor, with "special avoidance rights" not available to trustees in bankruptcy and that interferes with creditors' ability to avail themselves of the protections of federal law is preempted. *Id.* at 1202, 1205-06. (Pet. App. 7a, 12a to 13a).

REASONS FOR DENYING THE PETITION

I. THE COURT OF APPEALS' DECISION IS NOT A MATTER OF NATIONAL IMPORTANCE AS THE DECISION WILL HAVE MINIMAL IMPACT ON THE ADMINISTRATION OF BANKRUPTCY ESTATES AND OUT-OF-COURT LIQUIDATIONS ADMINISTERED UNDER STATE LAW.

A. The Court of Appeals' decision does not call into question the validity of assignments for the benefit of creditors and, on its face, has no application to individual creditor remedies or State laws governing the liquidation of corporate debtors.

The Petitioner's contention that the Court of Appeals' ruling can be read to preempt "general assignments" and "state laws that govern distribution to creditors" is without merit and cannot survive even a cursory review of the Court of Appeals' decision and its rationale. The sole issue addressed by the decision below is whether a state statute that vests unregulated assignees selected by the debtor with "new avoidance powers" not found at common law and unavailable to both individual creditors and the debtor alike is preempted by federal bankruptcy law. *Id.* at 1202, 1205-06. (Pet. App. 5a to 6a, 12a to 13a). The Court's ruling that a California statute that grants "state assignees entirely new powers that are not derived from contract and trust law" cannot fairly be read to invalidate an assignor's common law rights to convey property in trust or to specify how the proceeds of that property are to be distributed among beneficiaries. *See id.* at 1206 n.8. (Pet. App. 16a).

Indeed, so as to remove any doubt as to the scope of its holding, the Court of Appeals took pains to point out that it did not question the validity of common law assignments or of state law remedies available to individual unsecured creditors. *Id.* at 1204-05 & nn.6, 8. (Pet. App. 10a to 11a, 15a to 16a). Viewed in its proper context, therefore, the Court of Appeals' decision confirms that rights and powers that existed at common law do not conflict with the Bankruptcy Code or otherwise trespass on the field of bankruptcy, and leaves undisturbed a host of statutory provisions enacted in California (and elsewhere) to clarify and codify such common law rights. *See, e.g.*, Cal. Civ. Code § 22.2 ("The common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this State, is the rule of decision in all the courts of this State."); Cal. Civ. Code § 1954.1 (recognizing the right of assignee to occupy business premises); Cal. Civ. Code § 3439.07(d) (authorizing assignee to exercise any rights and remedies available to individual creditors in connection with bringing a fraudulent transfer action); Cal. Civ. Proc. Code § 493.010 (defining a "general assignment for the benefit of creditors"); Cal. Civ. Proc. Code § 1802 (requiring that creditors receive notice of the assignment and the deadline for submission of claims to the assignee, and setting forth the assignor's obligation to provide the assignee with a list of creditors, shareholders and other parties in interest); Cal. Civ. Proc. Code § 1204 (providing for priority treatment of claims for wages, salaries, commissions, and employee benefit contributions); Cal. Civ. Proc. Code § 1204.5 (priority for consumer deposit claims).

B. Extra-judicial state law liquidations are not inherently less expensive or more equitable than liquidations effected through bankruptcy.

The Petitioner's claims that the decision below will (i) "leave debtors and creditors with no choice but to take insolvencies into bankruptcy," and (ii) "push corporations from the less stigmatic, less costly voluntary assignment scheme into the world of federal bankruptcy," have no basis in law or fact. (Petition for Writ of Certiorari ("Petition") at 7, 17).

First, as a threshold matter, the Petitioner has not proffered any evidence whatsoever that corporate liquidations through general assignments are less costly or more efficient than bankruptcy liquidations. In fact, the record in this case demonstrates that such non-bankruptcy liquidations can be (and often are) more expensive than liquidations effected through federal law because, among other things, an assignee's fees, unlike those of a trustee in bankruptcy, are not capped pursuant to § 326 of the Bankruptcy Code, and the fees and expenses an assignee and its professionals incur in winding down a corporation are not subject to judicial review and reduction pursuant to §§ 328 and 330 of the Bankruptcy Code. *See* 11 U.S.C. §§ 326(a), 328(a) & (c), 330(a) (2005).

For example, under the sliding scale established by § 326 of the Bankruptcy Code, a trustee's compensation is determined on the basis of all monies disbursed or turned over in the case to parties in interest, and is limited to: "25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000, but not in excess of $50,000, and 5 percent on any amount in excess of $50,000, but not in

excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such monies in excess of $1,000,000." 11 U.S.C. § 326(a). In this case, in contrast, the Petitioner was able to obtain a contractual fee of "the greater of (i) $75,000, or (ii) 7.5% of the total amount of funds generated from the sale of any liquidation of Assignor's assets, including all funds administered by Assignee." This likely translates into a considerably larger expense than would be incurred in a federal bankruptcy case.

For instance, if this estate were to distribute $500,000, the Petitioner's fee would be $75,000, while a trustee's fee under § 326 of the Bankruptcy Code would be only $28,250, yielding a cost difference of $46,750. For estates in excess of $1,000,000, this cost differential begins to grow dramatically: if the estate were to distribute $2,000,000, the difference expands to $66,750; if the estate distributes $5,000,000, the difference swells to $201,750; if the estate distributes $10,000,000, the difference grows to $426,750; and so on. *See id.* These numbers undermine completely any claim by Petitioner that unsupervised, out-of-court liquidations administered by an assignee are inherently cheaper than bankruptcy liquidations.

Furthermore, it appears that excessive compensation of this sort is not unusual in general assignments. *See, e.g,* Geoffrey L. Berman, *General Assignments For The Benefit Of Creditors, A Practical Guide* 5 (2000) (noting that assignee fees can be as much as 20% of the funds administered and disbursed but observing that "on average, [an assignee's] fees will range from five to ten percent of the proceeds generated"). Finally, in contrast with general assignments, the reasonableness of a bankruptcy trustee's fees and expenses and the fees and expenses of the trustee's

professionals is vigorously policed by creditors, the United States Trustee and ultimately the federal bankruptcy courts, further reducing the relative administrative cost of bankruptcy. *See, e.g.*, 11 U.S.C. § 330 (requiring bankruptcy courts to review the reasonableness of compensation sought in bankruptcy cases, and authorizing the court on its own motion, the motion of the United States Trustee or any other party in interest to award less compensation than requested); Stefan A. Riesenfeld, *Creditors' Remedies And Debtors' Protection* 453 (4th ed. 1987) ("Is there any reason for advising liquidation under state law other than the possibility of higher fees for the lawyers?").

Similarly, Petitioner's assertion that state law liquidations are less "stigmatic" than bankruptcy cases is both irrelevant and just plain wrong. Because a discharge is only available in bankruptcy and is unavailable to corporations that are liquidated under Chapters 7 or 11 of the Bankruptcy Code, the vast majority of assignments are by corporate debtors, rather than individuals, for whom a discharge is of paramount concern. And these corporate debtors simply dissolve after making assignments. Tabb, *The Law of Bankruptcy* § 1.5 at 28. There is, consequently, no entity left to which any supposed stigma could attach.

C. The substantial majority of States have no preference laws whatsoever.

More importantly, the Petitioner's prophesy that the Court of Appeals' decision sounds the death knell of state law general assignments is demonstrably false. After all, the substantial majority of states, 35 in total, do not have any preference recovery statutes on the books at all. Yet, even absent such preference recovery provisions, common law and

statutory assignments for the benefit of creditors remain viable alternatives to bankruptcy in each of these jurisdictions. *See generally*, Berman, *General Assignments For The Benefit Of Creditors, A Practical Guide* at 52-58 (compiling various state assignment statutes). And general assignees in these states apparently continue to liquidate corporations outside of bankruptcy without the assistance of statutes vesting them with "special avoidance powers" comparable to either Cal. Civ. Proc. Code § 1800 or § 547 of the Bankruptcy Code.

D. The Petitioner also misstates the impact of the Ninth Circuit's decision on those states in which the Petitioner alleges that preference statutes continue to be "on the books."

The Petitioner indulges in yet more hyperbole when it claims that the Court of Appeals' ruling is of "vital importance" because it "effectively call[s] into question the voluntary assignment laws of at least 15 other states that authorize an assignee to recover preferential transfers." *See* Petition at 8. This claim is flawed first because it is based on the mistaken assumption that the statutes it cites are equivalent to Cal. Civ. Proc. Code § 1800, and second because such so-called state preference statutes are apparently not widely and frequently used in state court proceedings to avoid and recover transfers that would otherwise be within the ambit of § 547. Specifically, in contrast with Cal. Civ. Proc. Code § 1800, at least five of the remaining 15 state statutes to which Petitioner cites, on their faces, empower individual unsecured creditors to recover potential transfers.[1]

1. In sharp contrast with Cal. Civ. Proc. Code § 1800, "any creditor" can bring claims under Ohio's and Kentucky's "preference" (Cont'd)

The decision below simply has no application to such statutes and the Court of Appeals could not have been any more explicit that its ruling applies only to "special avoidance rights" not available to individual unsecured creditors.[2] *See Sherwood*, 394 F.3d at 1205-06. (Pet. App. 12a to 13a). At most, therefore, the rationale of the Court of Appeals could only apply to statutes in ten other states.

Moreover, the Petitioner's unsupported claim that state preference statutes outside of California are widely and frequently used is belied by both case law and academic commentary. In contrast with the thousands of reported decisions involving the federal bankruptcy statute, there is scant federal or state authority applying and interpreting the state preference statutes cited in the Petition. While an

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(Cont'd)

statutes (Ky. Rev. Stat. Ann. § 379.060, and Ohio Rev. Code Ann. § 1313.58). Similarly, N.M. Stat. Ann. § 56-9-2 allows "any interested person" to sue to recover transfers made with the "design to prefer one or more creditors." Finally, the "preference" statutes on the books in Arizona and Texas facially authorize creditors to recover transfers that "give preference" if an assignee "neglects or refuses" to do so. *See* Ariz. Rev. Stat. § 44-1041; Tex. Bus. Com. Code § 23.09.

2. Petitioner's claim that the decision below would preempt the Uniform Commercial Code in "all 50 states" reveals a similarly flawed understanding of the Court of Appeals' holding and its rationale. Under Article 9 of the Uniform Commercial Code, an assignee is treated as a "lien creditor," that is as a creditor who has acquired a lien on the property assigned "by attachment, levy, or the like." *See* UCC § 9-102(52). Individual creditors, of course, are likewise able to obtain such liens through litigation. Accordingly, that state law chooses to treat a debtor's assignment of its property to an assignee as a lien in favor of the assignee simply does not implicate the decision in this case or its rationale.

electronic search of decisions citing to the federal preference statute, § 547 of the Bankruptcy Code, turns up more than 4,000 cases since 1978 (the year the Bankruptcy Code was enacted), there are only 42 reported federal cases during that same 27 year period that cite to state preference laws like Cal. Civ. Proc. Code § 1800, and 33 of those cases are from Kentucky and Ohio, where individual creditors can bring preference claims, as noted above. Similarly, for more than half of the state preferences statutes cited by the Petitioner, there has not been a single reported state court decision since 1978, and the remaining statutes gave rise to little more than a dozen reported state court cases in total over the past 27 years.[3] These numbers speak for themselves – state preference law is antiquated, vestigial, practically moribund and outside of California has been almost entirely displaced by federal bankruptcy law. Any notion that the decision of the Court of Appeals implicates a matter of "national importance" is, under these circumstances, a flight of fancy.

Finally, a review of the few reported decisions discussing those state statutes further undermines Petitioner's contention that state preference law is "a matter of national importance." *See, e.g., In re Roberds, Inc.*, 313 B.R. 732 (Bankr. S.D. Ohio 2004) (holding that Ohio's intent to prefer statute does not apply to the payment of a lawful debt in money, as opposed to the other forms of property); *Smith v. Cox*, 831 P.2d 981,

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3. Specifically, the "preference" statutes cited in the Petition in the following States have not been the subject of a single reported federal or state court decision since enactment of the Bankruptcy Code in 1978: Arizona; New Hampshire; New Mexico; South Carolina; South Dakota; Tennessee; and Texas. And the following states' "preference" statutes were cited in a total of just 13 reported state court decisions since 1978: Kentucky; Maryland; New Jersey; New York; North Carolina; and Ohio.

983 n.1 (N.M. 1992) ("[w]hile we recognize that . . . [New Mexico's anti-preference statute] specifically addresses questions of preferential transfers, we have omitted any discussion of this statute because the parties failed to raise it at any time"). Academic commentary likewise confirms that the state statutes cited to by the Petitioner are not part of the fabric of commercial law but instead are largely irrelevant outside of California. *See, e.g.*, Douglas C. Michael, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 Ky. L.J. 937, 958 (1994) (commenting that reported decisions show that "courts or counsel have apparently ignored or overlooked" the preference statute on the books in New Mexico); Thomas D. Buckley, *The Use of Ohio's Preference Law in Bankruptcy: An Alternative to Section 547 with a Longer "Reach Back" Period*, 20 Cap. U. L. Rev. 863, 865 (1991) (commenting that although the Ohio preference statute has a longer reach back period than § 547, and can be enforced by a non-preferred creditor in state court (and therefore a trustee in bankruptcy under § 544(b)), this potential advantage has been "generally overlooked" even though its "use could have made a difference in the outcome in some recent cases"). Put bluntly, in these circumstances, notwithstanding Petitioner's exaggerations to the contrary, the decision below simply does not give rise to a matter of "vital importance" that warrants this Court's time and attention.

II. THE DECISION BELOW DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT AND THERE IS NO SPLIT OF AUTHORITY ON THE NARROW ISSUE DECIDED BY THE NINTH CIRCUIT.

A. No other Circuit has even considered the narrow issue raised in this case, much less resolved that question inconsistently with the decision below.

Further evidencing that the narrow question decided below is not likely to recur, the Petitioner does not (and cannot) point to any split of authority on the issue among the Circuits or state courts in support of its request for certiorari. Confronted with this absence of any apparent conflict among modern courts, Petitioner instead attempts to conjure up a conflict "with the governing decisions of this Court." *See* Petition at 19. The Petitioner's claim, however, is flatly wrong. The simple truth is that this Court has never addressed the narrow issue raised in this case – whether the Bankruptcy Code preempts a state statute that vests assignees selected by the debtor with "special avoidance powers" unavailable to individual unsecured creditors and bankruptcy trustees. Nor is there any need for the Court to do so now. Each of this Court's prior cases cited in the Petition, which address the fundamentally distinct issue of the degree to which the states can regulate common law assignments and make remedies available to individual creditors, is readily reconciled with the Ninth Circuit's decision below. Equally important, the narrow issue raised in this case is not likely to recur for the simple reason that federal bankruptcy law has effectively replaced "state preference law" outside of California, even in those few states with such laws ostensibly "on the books."

B. The validity of so-called "state anti-preference statutes" was not raised, discussed or decided in either *Pobreslo* or *Star*.

Contrary to the Petition, neither *Pobreslo*, 287 U.S. 518, nor *Johnson v. Star*, 287 U.S. 527 (1933), "upholds" preference statutes. Neither case involved the recovery of preferential transfers from creditors by state law custodians. Just the opposite, both cases involved attempts by creditors of an assignor/debtor to reach property in the hands of an assignee for the benefit of creditors. And each case upheld assignments "which do not differ substantially from those arising under common law assignments for the benefit of creditors" and statutes which regulated "substantive rights" derived from contract and trust law. *Pobreslo*, 287 U.S. at 526; *see Star*, 287 U.S. at 528-30.

More importantly, although each case either quotes or extensively summarizes the provisions of the statute regulating the assignments under consideration by the Court (in fact, *Pobreslo* quotes the statutory provisions at issue in the case in full in the margin), neither case discusses, quotes from or otherwise references statutory provisions that empower custodians to recover preferences. Neither case, therefore, can be read as "upholding" such statutes. Indeed, it is impossible to determine from the four corners of *Pobreslo* or *Star* whether or not the state law at issue in either case empowered assignees to avoid preferential transfers. In short, therefore, Petitioner's characterization of these cases as upholding "state anti-preference statutes" when the validity of such statutes was not raised, discussed or decided, is inaccurate and misleading. *Cf. Webster v. Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon,

are not to be considered as having been so decided as to constitute precedents."). More importantly, *Pobreslo*'s and *Star*'s ratification of general assignments and state statute's regulating such assignments is fully consistent with the decision below, as the Court of Appeals expressly found that "federal law coexists peaceably with, and often expressly incorporates, state laws regulating the rights and obligations of debtors (or their assignees) and creditors." *See Sherwood*, 394 F.3d at 1201. (Pet. App. 4a).

C. The Petitioner's reliance on *Stellwagen* is misplaced.

Similarly, the Court of Appeals' decision is not at odds with this Court's decision in *Stellwagen v. Clum*, 245 U.S. 605 (1918). In *Stellwagen*, this Court ruled that "§ 6343 of the Revised Statutes of Ohio," which provided for, among other things, the avoidance of transfers by a debtor "in contemplation of insolvency and with a design to prefer one or more creditors to the exclusion of others," was not preempted by enactment of the Bankruptcy Act. 245 U.S. at 618. Ohio's Section 6343, however, is a singular statute and, as the Court of Appeals properly found below, is fundamentally different from Cal. Civ. Proc. Code § 1800 in not less than three material ways.

First, in contrast with Cal. Civ. Proc. Code § 1800, the Ohio law at issue in *Stellwagen* empowered creditors rather than custodians to commence civil actions to avoid transfers under § 6343. The importance of this difference to the Court's holding cannot be understated. Because "any creditor" rather than the debtor's hand-picked assignee could commence an action to recover property avoidable under § 6343, those same rights were available to bankruptcy trustees under the statutory precursor to § 544(b) of the Bankruptcy Code,

§ 70e of the Bankruptcy Act. Just like § 544(b), § 70e vested bankruptcy trustees with the rights of individual creditors – rather than custodians – under state law. *See* Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part II)*, 47 N.Y.U. L. Rev. 631, 662-63 (1972) ("More troublesome is a state statute which can be invoked only by a 'receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation.' Here again, it does not seem proper to hold that this language includes a bankruptcy trustee. And, since it clearly does not include an individual creditor with a provable claim, the use of section 70e to invoke such a statute can be justified only by reading 'any creditor,' in section 70e to include any representative of any creditor. If that result is intended, it would be desirable to amend section 70e to say so.") (internal footnotes omitted). The fact that bankruptcy trustees could use § 6343 to recover property otherwise unavailable to bankruptcy estates was indispensable to this Court's determination in *Stellwagen* that the statute at issue was not preempted by the Bankruptcy Act. *Stellwagen*, 245 U.S. at 217, 219 (noting that in contrast with federal law, Ohio law had a four year rather than a four month reachback period for property avoidable under § 6343, and that the Court's holding that § 6343 is not preempted is expressly premised on "the provisions of section 70e"). In contrast, Cal. Civ. Proc. Code § 1800 vests custodians chosen by debtors with avoidance rights not available to other creditors and hence not available to bankruptcy trustees under § 544(b). In light of this fundamental distinction, *Stellwagen* cannot in any way be read as ratifying such a statute.

Second, the remedial provisions of § 6343 at issue in *Stellwagen* are materially different from Cal. Civ. Proc. Code § 1800. Under § 6344, upon obtaining a judgment declaring a transfer void, a creditor's remedy was the appointment of

a receiver to "take charge of all of the assets of such debtor or debtor's, including the property so . . . transferred," which receiver was required to administer these assets "for the equal benefit of creditors." That receiver, however, was appointed by a "court of competent jurisdiction" rather than a self-interested debtor and was required to be "duly qualified." *Stellwagen*, 245 U.S. at 609 n.1. Under Cal. Civ. Proc. Code § 1800, in contrast, the custodian who "administers" preference recoveries obtained involuntarily from out-of-state creditors like Lycos is not appointed or supervised by a state court and not required to be disinterested or otherwise "duly qualified" to administer impartially the proceeds of such litigation. *See Sherwood*, 394 F.3d at 1204. (Pet. App. 10a to 11a).

Although other provisions of § 6344 apparently vested "assignees," as well as creditors, with the right to commence lawsuits to avoid and recover transfers, in contrast with the case below, *Stellwagen* did not involve an assignment or an assignee's efforts to recover an alleged preferential transfer. Accordingly, the provisions of § 6344 empowering assignees to recover such transfers were not discussed, analyzed or approved by this Court in *Stellwagen*. Nor did they play any part in the Court's holding that bankruptcy trustees who succeeded to the rights of creditors rather than custodians under the Bankruptcy Act could use that state law to recover property otherwise unavailable to bankruptcy estates. At bottom, therefore, this Court in *Stellwagen* did not in any way endorse the unregulated, extra-judicial "administration" of preference recoveries from foreign creditors contemplated by Cal. Civ. Proc. Code § 1800.

Third, the peculiar statute at issue in *Stellwagen*, with its apparent focus on the debtor's and the transferee's state of mind, is more closely akin to fraudulent transfer law than to a modern preference statute such as § 547 of the Bankruptcy Code or Cal. Civ. Proc. Code § 1800. Facially, the so-called "preference provisions" of § 6343 focus on the parties' intent rather than the dividend available to similarly situated creditors. This distinction readily distinguishes § 6343 from modern preference statutes, where the inquiry is limited exclusively to the *pro rata* dividend available to creditors of the same class. *Cf.* H.R. Rep. No. 95-595, at 178 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6139 ("a creditor's state of mind has nothing whatsoever to do with [preference law's] policy of equality of distribution, and whether or not he knows of the debtor's insolvency does little to comfort other creditors similarly situated who will receive that much less from the debtor's estate as a result of the prebankruptcy transfer to the preferred creditor"); *Carruthers v. Kennedy*, 166 N.E. 801, 803 (Ohio 1929) ("A larger degree of moral turpitude is involved in a transaction with intent to hinder, delay and defraud creditors than is involved in a transaction with a design to prefer one or more creditors to the exclusion of others."); Douglas C. Michael, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 Ky. L.J. 937, 958 (1998) (recognizing that the parties' intent is a defining characteristic of fraudulent transfer law not preference law and noting that "[i]n Ohio, the confusion between fraudulent transfers and preferences has reached the statutory level"). Fraudulent transfer laws and modern preference laws are separate and fundamentally distinct bodies of law, and this Court's analysis of the antiquated fraudulent conveyance statute at issue in

Stellwagen sheds little light on whether or not state preference statutes are preempted by federal bankruptcy law.[4]

In sum, the decision below is by no means "in direct conflict" with *Stellwagen*. The Court of Appeals fully considered that case and properly concluded that Cal. Civ. Proc. Code § 1800 is a very different statute than the statute at issue in *Stellwagen* some 87 years ago.

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4. The Supreme Court has characterized the fundamental difference between a fraudulent transfer and a preference as follows:

> One is inherently and always vicious; the other innocent and valid, except when made in violation of the express provisions of a statute. One is *malum per se* and the other *malum prohibitum* – and then only to the extent that it is forbidden. A fraudulent conveyance is void regardless of its date; a preference is valid unless made within the prohibited period.

Van Iderstine v. National Discount Co., 227 U.S. 575, 582 (1913); *see also* 1 Garrard Glenn, *Fraudulent Conveyance and Preferences*, § 1 ("The preference materially differs from the fraudulent conveyance because it sins, not against the single creditor's right of realization, but only against the collective right of creditors as a class, that arises when their debtor becomes insolvent.") (rev. ed. 1940).

CONCLUSION

For the foregoing reasons, Lycos respectfully submits that the Petition should be denied.

Respectfully submitted,

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No. 04-1607

In The
Supreme Court of the United States

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,

Petitioner,

vs.

LYCOS, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICI CURIAE*, RECEIVERS, INCORPORATED AND UECKER & ASSOCIATES, INC., IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF

Pursuant to Rule 37.2(b) of this Court, Receivers, Incorporated ("Receivers") and Uecker & Associates, Inc. ("Uecker") move for leave to appear as *amici curiae* and file the accompanying *Amici Curiae* Brief in support of Petitioner Sherwood Partners Inc.'s ("Sherwood") Petition for a Writ of Certiorari. Petitioner has consented to the filing of this brief; Respondent has not. Petitioner's letter of consent has been filed with the Clerk of the Court.

As explained in more detail in the Statement of Interest in the accompanying brief, Receivers and Uecker are private corporations that regularly act as fiduciaries with respect to insolvency matters. They are frequently appointed by courts as receivers, trustees or other fiduciaries and regularly accept assignments for the benefit of creditors for the purpose of liquidating the assets of an assigning debtor, administering the assignment trust estate and distributing assets to creditors as appropriate. As assignees for the benefit of creditors, they many times have sought the recovery of preferential transfers under California Code of Civil Procedure Section 1800 – which has been part of California's insolvency law for nearly thirty years and which the Ninth Circuit panel majority, over vigorous dissent, has now declared is in conflict with and pre-empted by the Bankruptcy Code. Accordingly, *amici* are directly impacted by the Ninth Circuit's decision. It impairs their ability to exercise rights that have been part of California's insolvency law for decades, adversely affecting their efficient and cost effective administration of assignment trust estates.

Because Receivers and Uecker regularly act as fiduciaries in a wide variety of contexts, they can provide the Court with a special perspective on the role assignments for benefit of creditors have historically played in California law.

This case presents significant issues concerning (1) the relationship of federal and state law in the insolvency area, (2) congressional intent in enacting significant parts of the Bankruptcy Code and (3) the authority of states to enact laws concerning insolvency issues that are designed and intended to provide debtors with more efficient and less costly alternatives to formal bankruptcy proceedings. Fifteen other states have insolvency laws the same as or similar to California's statute. Thus, the Ninth Circuit's pre-emption ruling has ramifications far beyond California's borders.

Receivers and Uecker therefore respectfully move for leave to appear as *amici curiae* and file the accompanying brief.

Respectfully submitted,

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TABLE OF CONTENTS

	Page
AMICI CURIAE INTEREST AND AUTHORITY	1
INTRODUCTION	2
ARGUMENT	4
I. The Ninth Circuit's Decision Is At Odds With Three Long-Standing Decisions Of This Court	4
A. This Court's Decisions Upholding State Insolvency Statutes With Language Parallel To That Of California's Statute Are Controlling	4
B. The Ninth Circuit's Decision Both Ignores And Misreads This Court's Decisions Upholding Other State Insolvency Statutes	7
C. The Ninth Circuit Is Simply Wrong In Its Reading Of The State Insolvency Statute At Issue In *Stellwagen* – There Is No Substantive Difference Between That Statute, Which This Court *Upheld*, And California's Section 1800	12
II. California's Section 1800 Does Not Interfere With Federal Bankruptcy Objectives	15
CONCLUSION	18

TABLE OF AUTHORITIES

Page

CASES

Brainard v. Fitzgerald, 3 Cal. 2d 157, 44 P.2d 336 (1935) 8, 13

Johnson v. Star, 287 U.S. 527 (1933) ..... *passim*

Mechanics Bank of Richmond v. Rosenberg, 201 Cal. App. 2d 419, 20 Cal. Rptr 202 (1962) 13

Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933) ..... *passim*

Saks v. Damon Raike & Company, 7 Cal. App. 4th 419, 8 Cal. Rptr. 2d 869 (1992) 13

Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198 (9th Cir. 2005) ..... *passim*

Stellwagen v. Clum, 245 U.S. 605 (1918) ..... *passim*

Triplett v. Williams, 269 Cal. App. 2d 135, 74 Cal. Rptr. 594 (1969) 13

Women's Athletic Club v. Anglo California National Bank, 90 Cal. App. 2d 850, 204 P.2d 411 (1949) 13

STATUTES

Cal. Civ. Code § 22.2 14

Cal. Civ. Code § 493.010 7

Cal. Civ. Code § 493.020 ..... 8, 9

Cal. Civ. Proc. Code § 1800 ..... *passim*

Cal. Stat., 1997, ch. 499, § 2 8

11 U.S.C. § 547 11

TABLE OF AUTHORITIES – Continued

Page

1 Tex. Rev. Civ. Stat. Title 12, art. 268 (1925) 5, 14

1 Wis. Stat. § 128.02 (1929) 14

1 Wis. Stat. § 128.03 (1929) 14

1 Wis. Stat. § 128.05 (1929) 5

2 Ohio Rev. Stat. § 6343 (1905) 6

2 Ohio Rev. Stat. § 6344 (1905) 6

30 Stat. 544 § 60a (1898) 11

30 Stat. 544 § 60b (1898) 11

151 Cong. Rec. E704 (daily ed., Apr. 14, 2005) 16

MISCELLANEOUS

Restatement (Second) of Trusts § 282 13

Countryman, "The Concept of a Voidable Preference in Bankruptcy," 38 Vanderbilt Law Rev. 713, 719, *et seq.* (1985) 11

AMICI CURIAE INTEREST AND AUTHORITY[1]

As described in the accompanying motion for leave to file, *amici curiae* are two privately-owned, California businesses that serve as fiduciaries in insolvency matters. They often have taken, and anticipate taking in the future, assignments for the benefit of creditors under California law. In fulfilling this role, *amici* have used, and desire to use in the future, the full range of rights and procedures available under California law to promote the efficient and cost-effective administration of assignment estates and to maximize the amount available for equitable distribution to all creditors.

The Ninth Circuit's decision in *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005) – holding California Code of Civil Procedure Section 1800 pre-empted by the Bankruptcy Code – directly impacts *amici's* ability to administer assignment estates and to provide fully for the equitable treatment of all creditors. The panel majority's ruling is unprecedented and affects not only insolvency proceedings in California, but also in fifteen states that have insolvency laws similar to California's.

As a practical matter, the Ninth Circuit's decision eliminates state insolvency proceedings that have for decades been a more efficient and less costly alternative to formal bankruptcy proceedings. Moreover, it effectively jettisons these state law proceedings in the face of decisions by this Court upholding their validity and endorsing their utility. *Amici* therefore submit this brief urging the

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[1] Pursuant to Rule 37.6, *amici* affirm that no party or their counsel authored, or paid for, this brief in whole or in part.

Court to grant Petitioner Sherwood's Petition for a Writ of Certiorari.

INTRODUCTION

The Ninth Circuit panel majority (Judges Kozinski and Graber), over a lengthy dissent (Judge D. W. Nelson), held California Code of Civil Procedure Section 1800 is pre-empted by the Bankruptcy Code. *Sherwood*, 394 F.3d at 1206. This statute, which has been part of California's insolvency law for nearly thirty years, establishes a procedure by which assignees for the benefit of creditors can recover, for the benefit of all creditors, preferential transfers by debtors. Fifteen other states have statutes like or similar to California's. For decades, these state statutes have provided debtors, both individuals and businesses, more efficient and less costly state alternatives to formal federal bankruptcy proceedings.

In ruling that California's statute "trench[es] too close upon the exercise of the federal bankruptcy power," *Sherwood*, 394 F.3d at 1205, the Ninth Circuit's decision conflicts with three long-standing decisions of this Court upholding similar state statutes and endorsing state insolvency proceedings. *Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518 (1933); *Johnson v. Star*, 287 U.S. 527 (1933); *Stellwagen v. Clum*, 245 U.S. 605 (1918). In attempting to distinguish these decisions, the panel majority did not read them closely enough and as a result identified distinctions of no consequence, as the dissent points out. *Sherwood*, 394 F.3d at 1207-8. In the insolvency law context, as in other technical areas of the law, detail matters. And overlooking detail can have profound ramifications, as this case illustrates, with the consequent

invalidation of a state law that, until the Ninth Circuit's decision here, had stood the test of time for more than a quarter century.

The panel majority's disdain for state insolvency procedures is unmistakable. It is also unfounded. And it is contrary to this Court's decisions consistently upholding laws providing for assignments for the benefit of creditors – indeed, upholding state laws providing the same procedures as California's law and which the panel majority now has condemned.

The panel majority also was seemingly oblivious to the anti-consumer bent of its decision. State insolvency laws, like California's assignment for the benefit of creditors statute, were designed and intended to provide an efficient, less costly alternative to formal federal bankruptcy proceedings. They have served that purpose well, and there is no justification for effectively eliminating this alternative, and burdening debtors, regardless of means, with the expense of formal bankruptcy proceedings. This only further depletes the debtor's assets to the detriment of creditors.

Accordingly, this case presents significant issues concerning (1) the relationship of federal and state law in the insolvency area, (2) congressional intent in enacting significant parts of the Bankruptcy Code and (3) the authority of states to enact laws concerning insolvency issues that are designed and intended to provide debtors with more efficient and less costly alternatives to formal bankruptcy proceedings. *Amici* urge the Court to grant Sherwood's petition for writ of *certiorari*.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION IS AT ODDS WITH THREE LONG-STANDING DECISIONS OF THIS COURT

In *Pobreslo*, 287 U.S. at 518, *Johnson*, 287 U.S. at 527, and *Stellwagen*, 245 U.S. at 605, this Court upheld the constitutionality of Wisconsin, Texas and Ohio insolvency statutes, respectively, all granting assignees for the benefit of creditors essentially the same preference recovery powers as California Code of Civil Procedure Section 1800. The Ninth Circuit's decision that Section 1800 is preempted by the Bankruptcy Code cannot be reconciled with these three decisions.

A. This Court's Decisions Upholding State Insolvency Statutes With Language Parallel To That Of California's Statute Are Controlling

There is no material difference between the powers granted assignees for benefit of creditors by the Wisconsin, Texas and Ohio statutes this Court has upheld, and the powers granted such assignees by California's Code of Civil Procedure Section 1800.

The Wisconsin statute at issue in *Pobreslo* provided:

> Whenever any insolvent debtor has made any conveyance or transfer of his property, with the intent to hinder, delay or defraud his creditors, or has made or suffered any conveyance, transfer or charge upon his property, which is void, by reason of being preferential or otherwise, and shall thereafter make a general assignment for the benefit of his creditors, it shall be lawful for such assignee or his successors to commence and

> prosecute to judgment any proper suit or suits to vacate such fraudulent conveyance, transfer or charge.

Vol. 1 Wisconsin Statutes Chapter 128, Section 128.05 (1929).

The Texas statute in *Johnson* provided in pertinent part:

> Except as to innocent purchasers for value, all property conveyed or transferred by the assignor previous to and in contemplation of assignment with the intent or design to defeat, delay or defraud creditors, or give preference to one creditor over another shall pass to the assignee by the assignment, notwithstanding such transfer; and the assignee, or in the case of his neglect or refusal, any creditor or creditors may in his name, upon securing such assignee against cost or liability, sue for, recover and collect the same, and cause the same to be applied for the benefit of creditors as other property belonging to the debtor's estate in the hands of the assignee.

Vol. 1 Revised Civil Statutes of the State of Texas, Title 12, Article 268 (1925).

The Ohio statute at issue in *Stellwagen* provided:

> Every sale, conveyance, transfer, mortgage or assignment, made in trust or otherwise by a debtor or debtors, and every judgment suffered by him or them against himself or themselves in contemplation of insolvency, and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and every sale, conveyance, transfer, mortgage or assignment made, or judgment procured by him or them to be rendered, in any manner, with intent to hinder delay

> or defraud creditors, shall be declared void as to creditors of such debtor or debtors at the suit of any creditor or creditors as hereinafter provided, and shall operate as an assignment and transfer of all the property and effects of such debtor or debtors, and shall inure to the equal benefit of such creditor or creditors in proportion to the amount of their respective demands, including those which are unmatured.

Vol. 2 Annotated Revised Statutes of the State of Ohio, Section 6343 (1905).

Ohio law also went on to provide,

> . . . and any assignee as to whom any thing or act mentioned in the preceding section shall be void, shall likewise commence a suit in a court of competent jurisdiction to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned, and shall administer the same for the equal benefit of all creditors as in other cases of assignments to trustees for the benefit of creditors.

Vol. 2 Annotated Revised Statutes of the State of Ohio, Section 6344 (1905).

While expressed in more modern language, California Code of Civil Procedure Section 1800(b) grants an assignee for the benefit of creditors essentially the same rights and powers granted assignees under the Wisconsin, Texas and Ohio statutes. California's statute contains a far more exact definition of what is and is not preferential, and of which transfers are recoverable and which are protected, for public policy reasons. The authority granted to assignees, however, is essentially the same. Thus, Section 1800(b) provides:

> Except as provided in subdivision (c), the assignee of any general assignment for the benefit of creditors (as defined in Section 493.010) may recover any transfer of property of the assignor:
>
> (1) To or for the benefit of a creditor;
>
> (2) For or on account of an antecedent debt owed by the assignor before the transfer was made;
>
> (3) Made while the assignor was insolvent;
>
> (4) Made on or within 90 days before the date of the making of the assignment or made between 90 days and one year before the date of making the assignment if the creditor, at the time of the transfer, was an insider and had reasonable cause to believe the debtor was insolvent at the time of the transfer; and
>
> (5) That enables the creditor to receive more than another creditor of the same class.

California Code of Civil Procedure, Section 1800(b) (1999).

Because the language of the Wisconsin, Texas, Ohio and California statutes are parallel, and because this Court has upheld the three former statutes, logic alone dictates Section 1800 also is valid and not pre-empted.

B. The Ninth Circuit's Decision Both Ignores And Misreads This Court's Decisions Upholding Other State Insolvency Statutes

The majority opinion cites *Pobreslo v. Joseph M. Boyd Co.* but does not mention that this Court *upheld* the Wisconsin statute before it. Instead, the majority opinion

cites *Pobreslo* only for its language that the Wisconsin statute "merely provided the procedure" by which the common law of assignments for benefit of creditors was to be carried out in that state, *Sherwood*, 394 F.3d at 1206 n.8, and for the commonplace proposition that a state statute which purports to give an insolvent debtor a discharge from his liabilities is unconstitutional in light of the Bankruptcy Code.[2] *Id.* at 1203.

If, according to the majority opinion, a state statute that merely embodies the procedures by which the common law of assignments for the benefit of creditors is carried out is not pre-empted by the Bankruptcy Code, *Sherwood*, 394 F.3d at 1206, n.8, then Section 1800 plainly meets that standard. California has long had common law concerning assignments for the benefit of creditors. *See*, *Brainard v. Fitzgerald*, 3 Cal. 2d 157, 163, 44 P.2d 336, 339 (1935); Report of the California Senate Judiciary Committee, Senate Bill 219, March 23, 1999 ("California law recognizes the common law procedure known as 'Assignment for the Benefit of Creditors . . . '"). The California common law was codified as California Civil Code Section 493.020 in 1977, providing for the making of an assignment for the benefit of creditors. Indeed, the California legislature declared: "It is the intent of the Legislature that Section 493.020 of the Code of Civil Procedure, as added by Section 1 of this act, is declaratory of existing law." California Statutes, 1977, chapter 499, section 2.

In the following legislative session, the California legislature enacted Section 1800 to provide the procedures

[2] No section of the California statute purports to "discharge" a debtor from his or her liabilities.

by which an assignment under Section 493.020 would be managed. This is exactly what this Court approved in *Pobreslo*. Yet, the majority opinion ignored the exact parallel between the Wisconsin statutes this Court approved in *Pobreslo* and the California statute it condemned in this case. This Court should grant a writ of *certiorari* to either disapprove its prior decision in *Pobreslo* or reverse the Ninth Circuit's decision in this case – these two cases cannot coexist in the same legal universe.

The majority opinion does not even cite *Johnson v. Star*, decided at the same time as *Pobreslo* and *upholding* a similar Texas insolvency statute. However, *Johnson* demonstrates that the panel majority's attempt to distinguish *Pobreslo* as merely providing the procedure for implementation of the state's common law is not a valid basis for distinction. As this Court observed, the Texas statute at issue in *Johnson* was evidently intended to fill the gap left by the 1878 repeal of the federal Bankruptcy Act of 1867. 287 U.S. at 528. Nothing about the statute suggested it merely declared existing Texas common law. Rather this Court said: "It [the Texas statute] established a complete system for the administration of property conveyed by insolvent debtors for the benefit of their creditors." *Id.* at 528 (citing *Tracy v. Tuffly*, 134 U.S. 206, 223 (1890)). Thus, the Texas statute was not merely procedural; it created substantive rights – rights this Court ruled were consistent with and *not* pre-empted by the then re-enacted federal Bankruptcy Act. It is impossible to reconcile *Johnson* and the Ninth Circuit's decision here ruling California's Section 1800 is pre-empted.

Finally, while the majority opinion discusses *Stellwagen v. Clum* – and even acknowledges this Court (once again) *upheld* the state statute at issue allowing assignees

to void certain preferential transfers – its explanation as to why *Stellwagen* does not also apply here fails to withstand analysis.

The majority opinion states the Ohio statute at issue in *Stellwagen* gave assignees only those powers also available to any creditor. *Sherwood*, 394 F.3d at 1205-1206. Why that distinction, even if true (which it is not, as shown in the following section), should make a difference is not cogently explained. The majority opinion does not cite a single case in which that distinction tipped the balance between a valid and an unconstitutional statute. Nor does the majority opinion provide any policy reason why that should be so.

At its heart, the Ninth Circuit's explanation rests on this single sentence: "Congress has thought carefully about how collective insolvency proceedings are to be conducted and set both substantive standards and elaborate procedural protections to ensure a result that is fair to debtors and creditors alike." *Id.* at 1205-1206. However, the majority opinion fails to point to any provision of the present Bankruptcy Code or its legislative history that so much as suggests Congress' "careful consideration of collective insolvency proceedings" contains any indication state preference recovery statutes are inconsistent with the Bankruptcy Code.[3] In the absence of any evidence of

[3] The majority opinion instead focuses on federal bankruptcy procedural protections, such as Bankruptcy Court supervision and appointment of trustees by an agency of the Department of Justice. *Sherwood*, 394 F.3d at 1204. But this is not any basis to find substantive pre-emption. Not one of the three state statutes this Court has *upheld* provided for supervision by the federal courts or the Department of Justice either. There is no basis in the record, or in any legal authority, for the majority's apparent belief that only "federal" supervision is good enough for insolvency matters.

Congress' intent to preempt preference recovery by assignees unless, historically, all creditors could take the same action, the Ninth Circuit's reasoning would mean the enactment of the Bankruptcy Code preempts all state law "collective insolvency proceedings." But we know that not to be the case.

Moreover, at the time the Wisconsin, Texas and Ohio statutes were examined by this Court, Congress had already enacted a bankruptcy law. That law also provided for the recovery of preferential transfers. Bankruptcy Act of 1898, Sections 60a and 60b.[4] Thus, the federal bankruptcy law examined in *Pobreslo*, *Johnson* and *Stellwagen* had a comprehensive preference recovery system. So did the Wisconsin, Texas and Ohio statutes. *Pobreslo*, *Johnson* and *Stellwagen* therefore make clear that congressional thought "about how collective insolvency proceedings are to be conducted" (including providing for recovery of preferences) is *not* incompatible or inconsistent with state law insolvency proceedings that include preference recovery systems. And since Section 1800 is analogous in nature and effect to the Wisconsin, Texas and Ohio statutes, so too, it is *not* incompatible or inconsistent with "congressional thought" on insolvency proceedings.

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[4] 30 Stat. 544, Sections 60a and 60b respectively. Later amendments made those sections very similar to the present Title 11, U.S.C. Section 547. For a detailed discussion of the state of the preference law during the relevant time frame, see Countryman, "The Concept of a Voidable Preference in Bankruptcy," 38 Vanderbilt Law Rev. 713, 719, *et seq.* (1985).

C. The Ninth Circuit Is Simply Wrong In Its Reading Of The State Insolvency Statute At Issue In *Stellwagen* – There Is No Substantive Difference Between That Statute, Which This Court *Upheld*, And California's Section 1800

The Ninth Circuit also distinguished the Ohio statute at issue in *Stellwagen* from California's Section 1800 on the ground the Ohio law gave the assignee no greater powers than were available to individual creditors. This is simply wrong. The Ohio law at issue in *Stellwagen* – which this Court *upheld* – is substantively exactly the same as California's Section 1800.

Ohio common law allowed individual creditors of an insolvent to recover preferential transfers by direct legal action. The Ohio statute at issue granted an assignee for benefit of creditors exactly the same powers in a collective proceeding.

Section 1800 provides for the same result; it simply follows a different way of getting there. Under Section 1800 an assignee is empowered to recover preferential transfers. The statute does not directly empower individual creditors to sue to recover preferential transfers for the benefit of all, but California common law grants individual creditors the right to enforce Section 1800 by filing their own suit. Individual creditors therefore possess all of the rights granted to the assignee for benefit of creditors, should the assignee fail to pursue a preference recovery action.

It is well established under California law that an assignee for the benefit of creditors is a trustee for the benefit of the assignor's creditors, not just a custodian for

the assignor. *E.g., Brainard*, 3 Cal. 2d. at 163, 44 P.2d at 339; *Mechanics Bank of Richmond v. Rosenberg*, 201 Cal. App. 2d 419, 424, 20 Cal. Rptr. 202 (1962). Likewise, under California law, where a trustee of a trust cannot or will not enforce a valid cause of action that the trustee ought to bring against a third person, a beneficiary of the trust may seek judicial compulsion against the trustee by suing directly and joining the trustee and the liable third party as defendants. *E.g., Saks v. Damon Raike & Company*, 7 Cal. App. 4th 419, 426-430, 8 Cal. Rptr. 2d 869, 873-7 (1992).[5]

Because an assignee for the benefit of creditors is a trustee, the failure of the assignee to pursue a preference claim under Section 1800 activates the potential right of a creditor, as a beneficiary of the assignment trust, to

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[5] For example, in *Saks*, the plaintiff, the beneficiary of a testamentary trust, sued both the trustee and a third party, alleging the beneficiary brought "this action for the benefit of all beneficiaries of the trust, including themselves; for the benefit of the subject trust; and on behalf of the current trustee of the subject trust which has failed and refused to bring this action despite demand having been made upon it to do so by plaintiffs." The *Saks* Court held "where a trustee cannot or will not enforce a valid cause of action that the trustee ought to bring against a third person, a trust beneficiary may seek judicial compulsion against the trustee in order to prevent loss of or prejudice to a claim the beneficiary may bring an action in equity joining the third person and the trustee." 7 Cal. App. 4th at 427-8, 8 Cal. Rptr. 2d at 873. Because the trust in the *Saks* case was a testamentary trust, the *Saks* Court held the beneficiary was required to sue in probate court. Nevertheless, the case reaffirms that it is perfectly appropriate for a beneficiary whose trustee fails or refuses to properly pursue a cause of action that belongs to the trust estate, to sue the third party directly, joining the reluctant trustee as a party defendant. *See also Triplett v. Williams*, 269 Cal. App. 2d 135, 137-138, 74 Cal. Rptr. 594, 595-7 (1969); *Women's Athletic Club v. Anglo California National Bank*, 90 Cal. App. 2d 850, 852, 204 P.2d 411, 412 (1949); *Restatement (2d) of Trusts*, § 282.

initiate such action, joining the assignee as a party defendant. Any recovery, of course, would inure to the benefit of all creditors because, as in the case of the Ohio statutes upheld in *Stellwagen*, the recovery is through the assignment estate. 245 U.S. at 619.

In short, California's common law and Section 1800, together, provide for the same result as the Ohio statutes that this Court held in *Stellwagen* were *not* pre-empted. The only difference is that California law supplies the beneficiary's right to sue through non-codified legal principle. But this is a difference without consequence because California draws no distinction between its statutory and common law – both are authoritative sources of the State's law. California Civil Code Section 22.2.

The state statutes this Court approved in *Pobreslo* and *Johnson* were similar, in enacting a statutory (as opposed to a common law) right for creditors to pursue preference recoveries on their own. In *Pobreslo*, the Wisconsin statute provided that a creditor could bring an action if the assignee neglected to do so within 60 days of the assignment. *See* Wis. Stat. §§ 128.02, 128.03 (1929). In *Johnson*, the Texas statute specifically provided that any creditor could bring an action in the name of the assignee if the assignee neglected or refused to do so. *See* Tex. Rev. Civ. Stat. Title 12, Vernon's Annotated Civil Statutes, Article 268. Neither statute granted a right to an individual creditor to sue to recover a preference outside the assignment for benefit of creditors context. That is exactly parallel with Section 1800.

Thus, under the California approach, the power to recover preferential transfers is granted to an assignee and, under recognized state common law, those powers are

made available to individual creditors. Under the Ohio approach in *Stellwagen*, the powers to recover preferential transfers were granted to individual creditors, and the statute in question passed those powers on to an assignee. In both cases the assignees and individual creditors both have the right to sue for preferential transfers. Accordingly, the Ninth Circuit's attempt to distinguish *Stellwagen* on the basis of individual versus collective action is simply wrong.

II. CALIFORNIA'S SECTION 1800 DOES NOT INTERFERE WITH FEDERAL BANKRUPTCY OBJECTIVES

The Ninth Circuit acknowledges that the foremost test of whether a state insolvency law is pre-empted is whether it purports to grant the debtor a discharge from its debts. *Sherwood*, 394 F.3d at 1203. Section 1800 does not even hint that an assignor acting under this section could procure a discharge for the debtor. Nor did the Circuit Court conclude Section 1800 suffered from this affliction.

Instead, the Ninth Circuit suggested several other supposed policy reasons why Section 1800 is pre-empted, none of which stand up under examination.

First, the majority opinion suggests Section 1800 chills the likelihood of involuntary bankruptcies, thereby injuring less diligent creditors. *Sherwood*, 394 F.3d at 1204-5. Not so. The only reason why a creditor might not join other creditors in an involuntary bankruptcy petition where an assignment for benefit of creditors has been made, is because the creditor has decided that the assignment process is at least as good for it as the possible bankruptcy. There is no reason to second-guess the creditor's choice of

an assignment over a bankruptcy. The assignment process carries no greater or different risks for creditors than the many other alternatives. Unless the Court believes that Congress intended to eliminate non-bankruptcy methods of resolving insolvent debtors' liquidations, no special prohibition on assignments is justified.[6]

Second, the majority opinion suggests recovery by an assignee from a preference transferee will make it impossible for a bankruptcy trustee to also recover from the same transferee, thereby diminishing the bankruptcy estate. *Sherwood*, 394 F.3d at 1204. Not so. If an assignee's recovery from a preference transferee precludes recovery by a bankruptcy trustee, the *creditors* are not affected by that fact – and it is the *creditors* that count, not the bankruptcy trustee. An assignee that recovers a preference does not throw the recovery away. He or she distributes it to the creditors. If a bankruptcy trustee recovers a preference, he or she distributes it to the creditors. Whoever recovers the preference, it is distributed to creditors. Creditors simply are not injured by the possibility of two fiduciaries seeking preference recoveries, even if one fiduciary recovers some preferences and another fiduciary

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[6] Quite to the contrary, Congress' view seems clear that bankruptcy should be employed to resolve insolvency problems only where it is truly necessary. *See, e.g.*, Remarks of Representative. Dennis Moore of Kansas concerning the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: "Bankruptcy filings have increased by 70 percent over the last decade, and last year alone Americans filed over 1.6 million consumer bankruptcy petitions. S. 256 will not eliminate bankruptcy filings in our country, but it is a necessary effort to change the status quo and ensure that only those debtors who most need the bankruptcy system will be able to use it." 151 Cong. Rec. E704 (daily ed., Apr. 14, 2005). Eliminating a state law alternative to bankruptcy does not help to keep people out of bankruptcy court.

recovers other preferences. The total of recoveries available to be distributed to creditors is the same.

Third, the majority opinion suggests Section 1800 paves the way for the inequitable treatment of creditors and posits a "parade of horribles" through which it might be possible for an assignment for the benefit of creditors to result in inequitable treatment of creditors. *Sherwood*, 394 F.3d at 1204-6. But the opinion does not point to a shred of evidence that this statute has ever lead to such a result. If such unsupported theorizing leads to a pre-emption conclusion, then the state statutes in *Pobreslo*, *Johnson* and *Stellwagen* would all be pre-empted, as well. Most, if not all, of the supposed "parade of horribles" would occur as easily under those statutes as under Section 1800.

Furthermore, the Ninth Circuit's reasoning would dictate the pre-emption of other long-established state laws. For example, the Uniform Fraudulent Transfer Act, adopted in most states, allows a single creditor to pursue a fraudulent transfer committed by its debtor and to keep the recovery for itself. That can easily result in inequitable distribution of a debtor's assets among its creditors, but no court has ever suggested the UFTA is pre-empted by the Bankruptcy Code. Similarly, does the bankruptcy goal of equitable distribution override the priorities given certain creditors under state judgment enforcement laws? To pass muster, must a state law exactly parallel the priorities in distribution under the Bankruptcy Code, or may a state, for example, put child support obligations in front of employee wages? The Ninth Circuit's position suggests that state laws making those choices are pre-empted. But that, of course, is far beyond the recognized bounds of federal pre-emption.

CONCLUSION

Seventy years ago this Court spelled out the basic ground rules for the relationship between federal bankruptcy law and state insolvency laws. When Congress enacted the latest version of the Bankruptcy Code, it gave no indication it intended to displace these state laws – *upheld* by this Court and which have been operative for decades. The Ninth Circuit's pre-emption decision is unprecedented; it conflicts with the prior decisions of this Court and it puts in question the insolvency laws of no less than fifteen states. *Amici* urge the Court to grant Sherwood's petition for writ of *certiorari*.

Respectfully submitted,

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IN THE

Supreme Court of the United States

SHERWOOD PARTNERS, INC., ~~Assignee~~ for the Benefit of Creditors of International Thinklink Corporation,

Petitioner,

v.

LYCOS, INC., a Delaware Corporation,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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CORPORATE DISCLOSURE STATEMENT

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

TABLE OF CONTENTS

	Page
CORPORATE DISCLOSURE STATEMENT	i
TABLE OF CONTENTS	ii
TABLE OF CITED AUTHORITIES	iii
INTRODUCTION	1
REPLY TO OPPOSITION	2
I. THE OPPOSITION MISCHARACTERIZES THE SCOPE OF THE NINTH CIRCUIT'S DECISION	2
A. The Opposition Ignores that the Basis for the Ninth Circuit's Decision Applies to Assignments for the Benefit of Creditors in General and is not Narrowly Limited to Anti-Preference Statutes ...	2
B. The Opposition Ignores this Court's Longstanding Precedent Upholding Assignments for the Benefit of Creditors that, by Definition, Seek the Equitable Distribution of an Insolvent Debtor's Assets	4
II. THE OPPOSITION AVOIDS DISCUSSING THE NINTH CIRCUIT'S FAILURE TO APPLY THE STRONG PRESUMPTION AGAINST PREEMPTION OF STATE LAW REQUIRED BY THIS COURT	6
CONCLUSION	8

TABLE OF CITED AUTHORITIES

	Page
Cases:	
Angeles Electric Co. v. Superior Court, 27 Cal. App. 4th 426, 32 Cal. Rptr. 2d 660 (1994)	7
Bates v. Dow Agrosciences, LLC, 125 S. Ct. 1788, 161 L. Ed. 2d 687, 73 U.S.L.W. 4311 (2005)	6
Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963)	6, 7
Johnson v. Star, 287 U.S. 527 (1933)	5
Medtronic Inc. v. Lohr, 580 U.S. 470 (1998)	7
PG&E Company, et al., v. People of the State of California, 350 F.3d 932 (9th Cir. 2003)	7
Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933)	4, 5
Stellwagen v. Clum, 287 U.S. 605 (1918)	5
Statute:	
Cal. Civ. Proc. Code § 1800	7

INTRODUCTION

The Ninth Circuit majority based its decision in this case on its incorrect determination that state insolvency laws that implicate equitable distribution of a debtor's assets are preempted by the federal Bankruptcy Code. Attempting to minimize the importance of this matter, the Brief in Opposition (the "Opposition") to the pending Petition for a Writ of Certiorari (the "Petition") mischaracterizes the majority opinion of the Ninth Circuit as a decision that does not apply generally to assignments for the benefit of creditors. Further, the Opposition fails to address the Ninth Circuit's departure from this Court's longstanding precedent that state assignment statutes providing for the equitable distribution of a debtor's assets are in "harmony" with federal bankruptcy law. Such statutes exist in approximately half of the states. Moreover, the Opposition ignores the Ninth Circuit's failure to apply the "strong presumption" against preemption of state laws required by this Court. Accordingly, the Ninth Circuit majority's decision is in direct conflict with this Court's governing precedent regarding (1) state law assignments as a valid means to promote equitable distribution to creditors, and (2) the requirement for federal preemption of state law. Neither of these flaws is addressed in the Opposition.

REPLY TO OPPOSITION

I. THE OPPOSITION MISCHARACTERIZES THE SCOPE OF THE NINTH CIRCUIT'S DECISION

A. The Opposition Ignores that the Basis for the Ninth Circuit's Decision Applies to Assignments for the Benefit of Creditors in General and is not Narrowly Limited to Anti-Preference Statutes

The Ninth Circuit's decision applies equally to all assignments for the benefit of creditors, not just those of California, and not just those assignment laws relating to preference actions. Indeed, as pointed out by Judge Nelson in her dissent, the Ninth Circuit's decision "would preempt any number of state laws governing voluntary assignments for the benefit of creditors. . . ." *Sherwood Partners, Inc., Assignee for the Benefit of Creditors of International Thinklink Corporation v. Lycos, Inc.*, 394 F.3d 1198, 1206 (9th Cir. 2005). (Pet. App. 17a). The Ninth Circuit strikes down California's anti-preference law because it furthers the goal of promoting equality of distribution to creditors. However, by definition, voluntary assignments are collective proceedings designed to achieve equitable distribution. As the dissent points out and the Opposition fails to address, "[t]he majority's concerns about section 1800 are not distinguishable from concerns about voluntary assignment provisions generally." *Sherwood*, 394 F.3d at 1206. (Pet. App. 19a).

The Opposition, like the Ninth Circuit majority, does not disguise its disdain for state voluntary assignment laws. Through several of its pages, the Opposition takes issue with an assignee's potential conflicts of interest, professional fees, administrative fees, incentives available to creditors for relief under state and federal law, and judicial supervision of an assignee's and its

professional's decisions. According to the Opposition, the federal system just runs better than the state law alternative. Indeed, a significant portion of the Opposition is dedicated to the thrashing of state voluntary assignment laws as opposed to argument concerning the real issues presented by the Petition. However, a bias favoring federal bankruptcy law over state law alternatives does not provide a valid basis for the preemption of state laws. Moreover, in revealing its disdain for state law, the Opposition makes the case that the scope of the Ninth Circuit ruling broadly applies to all voluntary assignment laws. Furthermore, the Opposition's statement that federal bankruptcy law has essentially replaced state voluntary assignment laws is pure fiction.[1] That assignment laws remain in effect in many states demonstrates their usefulness as valid alternatives to federal bankruptcy proceedings.[2]

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1. The Opposition's argument that there are less reported decisions for state assignment proceedings as opposed to federal preference proceedings is smoke and mirrors and as much a reflection on the limited reporting of state appellate law compared to the expansive reporting of bankruptcy court decisions, which are published at all levels of the bankruptcy process including, among others, bankruptcy court, district court, and bankruptcy appellate panel levels.

2. The Opposition offers an illustration as to the fees involved in a federal bankruptcy proceeding versus an assignment for the benefit of creditors. Aside from complete speculation, the analysis offers no facts involving the present matter and is completely irrelevant to the case at bar. Moreover, and also as irrelevant, the Opposition states that there is no stigma to assignments because the assignment estate ceases to exist after it is liquidated. This further evidences a lack of understanding of the assignment process where the assets of many assignment estates are sold as going concerns and the business of the assignor continues to operate under new ownership.

Similarly, the Ninth Circuit's discussion of the "procedural and substantive protections" offered by the federal bankruptcy system offers no insight into whether state statutes implicating equitable distribution are preempted by federal bankruptcy law. The Opposition's support of the Ninth Circuit's discussion of federal supervision of anti-preference actions could just as easily be applied to all the duties, rights and powers of an assignee.

B. The Opposition Ignores this Court's Longstanding Precedent Upholding Assignments for the Benefit of Creditors that, by Definition, Seek the Equitable Distribution of an Insolvent Debtor's Assets

This Court, in *Pobreslo,* upheld Wisconsin's assignment statute, requiring the equitable distribution of a debtor's assets, stating that the state law was ". . . in harmony with the purposes of the federal [bankruptcy] act . . . , served to protect creditors against each other and goes to assure equality of distribution." *Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 526 (1933). In direct conflict with this Court's governing precedent, the Ninth Circuit in the instant case held that, like state discharge laws, "state statutes that implicate the federal bankruptcy law's other major goal, namely equitable distribution," are preempted. *See Sherwood*, 394 F.3d at 1203. (Pet. App. 9a). The Ninth Circuit majority reasoned that because the federal bankruptcy law preempts state statutes that discharge the debtor in furtherance of the bankruptcy fresh start goal, the state laws that avoid preferential transfers are also preempted because these laws further equitable distribution. *See Sherwood*, 394 F.3d at 1203-05. (Pet. App. 7a to 10a).

The Opposition makes no effort to explain how the Ninth Circuit majority's preference for federal bankruptcy proceedings over state law assignment provisions that are designed to promote equitable distribution of an insolvent debtor's assets is not in direct conflict with this Court's governing precedent. Instead, the Opposition dismissingly suggests that the issues involved in *Pobreslo*, and this Court's decision in *Johnson v. Star*, 287 U.S. 527 (1933), are not present here.[3] The Opposition simply misstates the law. As is the case here, both of those cases involved state statutes governing the equitable distribution of a debtor's assets through an assignment process.

The Opposition further asserts that the Ohio statute at issue in *Stellwagen v. Clum*, 287 U.S. 605 (1918), where this Court upheld a state law assignment anti-preference statute, is distinguishable because the Ohio statute purportedly only gave assignees those powers also available to any creditor. Why that distinction, even if correct (which it is not, as discussed in the Petition), should make a difference is not explained. Neither the majority opinion nor the Opposition cite any authority nor provide any policy reason why that should be the case.

Like the Wisconsin statute at issue in *Pobreslo*, California's statute is in harmony with the purposes of federal bankruptcy laws and serves to assure an equitable distribution of assets. As stated by Judge Nelson in her dissent, "the nature of the regulated activity – distribution of the debtor's assets [and

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3. This Court upheld yet another state law in *Johnson v. Star*, which involved a preemptory challenge to the Texas voluntary assignment statute that also contained an anti-preference provision. *See Johnson v. Star*, 287 U.S. 527 (1933). This Court held that the statute was not "repugnant" to the Bankruptcy Act and that "this case is ruled by our decision in *Pobreslo*. . . ." *Star*, 287 U.S. at 530.

furthering the goal of equitable distribution]" – is not one rendering it impossible to conclude that the state and federal systems can peaceably coexist. *See Sherwood*, 394 F.3d at 1208. (Pet. App. 21a). That has been the governing precedent for more than seventy years and the Opposition offers no compelling reason for this Court to change course now.

II. THE OPPOSITION AVOIDS DISCUSSING THE NINTH CIRCUIT'S FAILURE TO APPLY THE STRONG PRESUMPTION AGAINST PREEMPTION OF STATE LAW REQUIRED BY THIS COURT

Notably missing from the Opposition is any discussion of the preemption doctrine, which is the foundation of the Ninth Circuit's decision. This Court requires a "clear and manifest" intention of Congress to preempt state law. *See Bates v. Dow Agrosciences, LLC*, 125 S. Ct. 1788, 161 L. Ed. 2d 687, 706, 73 U.S.L.W. 4311 (2005). A federal law will preempt state law only if the federal law is so pervasive as to make reasonable the inference that Congress left *no room* for states to supplement it. *See also Florida Lime & Avocado Growers, Inc. v. Paul ("Florida Growers")*, 373 U.S. 132, 160, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963).

> Because States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly preempt state law cause of action. In all preemption cases, and particularly in those in which Congress has "legislated . . . in a field which States have traditionally occupied" . . . States were not to be superceded by the Federal Act absent the clear and manifest purpose of Congress.

See Medtronic Inc. v. Lohr, 580 U.S. 470 (1998). "The presumption against displacing state law by federal bankruptcy law is just as strong in bankruptcy as in other areas of federal legislative power." *See PG&E Company, et al., v. People of the State of California*, 350 F.3d 932, 943 (9th Cir. 2003).

The determinative factor is whether California's anti-preference law may peaceably coexist with federal bankruptcy by not standing as an "obstacle" to the accomplishment and execution of the full purposes and objectives of Congress. *See Florida Growers*, 373 U.S. at 160. It is in this landscape that the Ninth Circuit's decision strays. In applying the federal preemption test enunciated in *Florida Growers*, it is evident that California's anti-preference statute is not an "obstacle" to federal bankruptcy law. Further, there is not even an indication of any congressional design to preempt state laws authorizing an assignee to avoid preferential transfers under voluntary assignment laws.

California's anti-preference provision was intended to align state law and federal bankruptcy law and "is, by design, virtually identical to the Bankruptcy Code's preferential transfer statute." *See Sherwood*, 394 F.3d at 1207; *see also Angeles Electric Co. v. Superior Court*, 27 Cal. App. 4th 426, 430-31, 32 Cal. Rptr. 2d 660 (1994) (discussing intentional conformance of section 1800 with federal bankruptcy law). (Pet. App. 19a). "That California's voluntary assignment system has such a provision [Cal. Civ. Proc. Code § 1800] makes it more capable of effecting the equality of distribution that is the aim of bankruptcy law; it does not necessarily interfere with bankruptcy's goal of achieving equal distribution." *See Sherwood*, 394 F.3d at 1207-08. (Pet. App. 20a). In the present case, there is no impediment to federal bankruptcy law and there is simply no

reason that the federal law and California's anti-preference statute may not "peaceably co-exist" as they have done so for almost 30 years. The Petition should be granted and the Ninth Circuit's decision should be reviewed and reversed by this Court.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

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